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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

POSTAL RATE AND FEE CHANGES, 2000

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DOCKET NO. R2000-1

DIRECT TESTIMONY OF
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ON BEHALF OF THE
NEWSPAPER ASSOCIATION OF AMERICA

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1 **I. INTRODUCTION AND SUMMARY**

2 **A. Introduction**

3 My name is William B. Tye. I have a Ph.D. in Economics, which I received from
4 Harvard University in 1969. I am a Principal and co-founder of *The Brattle Group*. My
5 office is located at 1133 20th Street NW, Suite 800, Washington, DC 20036. I have
6 been an economic consultant for over twenty years. I specialize in regulatory and
7 antitrust issues. My clients have included regulatory bodies, firms in regulated
8 industries, and law firms. I have authored or co-authored over one hundred papers and
9 publications, including four books. I am a past National President of the Transportation
10 Research Forum.

11 My experience with postal matters began with rate cases in 1974 and 1976. Since that
12 time I have testified before this Commission in two general rate proceedings and two
13 mail classification proceedings. These, along with my other experience and
14 qualifications are detailed in Appendix A to my prepared testimony.

15 On behalf of the Newspaper Association of America, I was asked to review the U.S.
16 Postal Service's (USPS) rate proposals for the Standard A Commercial Enhanced
17 Carrier Route (ECR) subclass. I was also asked to review the Postal Service's
18 proposals for other subclasses, including Standard A Regular, the Standard A Nonprofit
19 subclass, and the First Class Mail subclasses, to the extent that those proposals had
20 some relevance to Standard A ECR. For the purpose of my analysis, I am assuming,
21 except where specifically discussed, the cost data provided by the Postal Service.

1 **B. The Postal Service Does Not Justify Its Proposal To Lower The**
2 **ECR Pound Rate**

3 The Postal Service proposes to reduce the ECR pound rate substantially from current
4 levels. It cites a "cost study" produced by witness Daniel, although she herself refers to
5 it only as a "distribution key analysis."¹ I find that the data gathered for this analysis are
6 not reliable. I further find that the cost data are inconsistently applied to justify First
7 Class and Standard A rate design proposals, and that only results supportive of the
8 Postal Service's rate proposals are presented. Since the results of the distribution key
9 analysis are "cherry picked," they form no reliable basis for changes in the ECR pound
10 rate. No other substantive justification for a decrease in the ECR pound rate is offered
11 and the Postal Service's own testimony indicates that the decrease would harm private
12 sector firms. Accordingly, the proposal should be rejected by the Commission.

13 **C. The Postal Service Does Not Justify Its Proposal To Lower The**
14 **ECR Cost Coverage**

15 The Postal Service also proposes to reduce (after normalization) the cost coverage of
16 Standard A Enhanced Carrier Route mail from the level recommended by the
17 Commission in Docket No. R97-1. This proposal also includes rate designs that contain
18 a number of anomalies in the "passthroughs," which determine the percentage of
19 estimated cost savings from worksharing that show up in rate differences. These
20 anomalies occur for two reasons: 1) an apparent compartmentalization of the
21 responsibilities between the Postal Service witnesses responsible for rate design and

¹ Tr. 4/1386 (Daniel).

1 rate levels/cost coverages, and 2) the lack of sufficient "headroom" to allow better
2 recognition of costs avoided, due to the proposed lowering of the ECR cost coverage.

3 I find that the justifications for lowering the cost coverage for ECR are vague and
4 inconsistent. The only reason given by the Postal Service for reducing the cost
5 coverage for ECR Mail is that it is "high" and ought to come down. But this reasoning
6 ignores the by-now generally accepted principle that heavily work-shared subclasses
7 will have high cost coverages precisely because of the cost avoidance from
8 worksharing. Other measures, such as unit contributions, show that ECR mail pays a
9 much more modest contribution to overhead than First Class mail, and the difference
10 between the two would increase under the Postal Service's proposal. The Postal
11 Service ignores this discrepancy. The proposed lowering of ECR cost coverage, as
12 with the proposal to cut the pound rate, appears to be part of an ongoing effort to divert
13 ECR mail from private enterprise competitors, and should be rejected by the
14 Commission.

15 **D. Proposed Cost Coverage And Rate Design For ECR Mail**

16 Since neither the Postal Service's pound rate or cost coverage proposal is justified, the
17 question of what pound rate and what cost coverage to use remains rather open. I
18 recommend that the Commission adopt rates for commercial ECR that: (1) at least
19 maintain the unit contributions established in Docket No. R 97-1 using the
20 Commission's cost attribution methodology, after adjusting for actual 1999 costs, and
21 sufficient to ensure that the cost coverage or markup index does not decline in absolute
22 or relative terms; and (2) incorporate increases in the undiscounted ECR rates (instead

1 of the selective increases and decreases proposed by the Postal Service) sufficient to
2 achieve sound ratemaking goals.

3 **II. THE POSTAL SERVICE DOES NOT JUSTIFY ITS PROPOSAL TO CUT THE ECR**
4 **POUND RATE**

5 **A. The Commission Rejected Witness Moeller's Proposed Reduction**
6 **Of The ECR Pound Rate In Docket No. R97-1 And Should Do So**
7 **Again**

8 In Docket No. R97-1, the Commission considered and rejected a similar Postal Service
9 proposal to reduce the pound rate for ECR mail. The Commission concluded in that
10 proceeding that the ECR pound rate should not be reduced as proposed by the Postal
11 Service for two basic reasons:

12 Significantly, pricing considerations also militate against
13 recommending a substantial reduction in the pound rate. Criterion
14 (b)(4) of the Act requires that the Commission consider 'the effect
15 of rate increases upon the general public, business mail users,
16 and enterprises in the private sector of the economy engaged in
17 the delivery of mail matter other than letters.' 36 U.S.C. § 3622
18 (b)(4). In drafting such specific language, Congress clearly
19 conveyed its concern that the Commission particularly *consider*
20 *the effects of rate increases on enterprises that are in competition*
21 *with the Postal Service.*²

22 However, rate reductions not firmly supported by *reliable cost*
23 *evidence* that may jeopardize the visibility [viability] of small
24 businesses, such as the alternative delivery services represented
25 by AAPS, are not consistent with 39 U.S.C. § 3622(b)(4). While it
26 is unknown how a substantial decrease in the pound rate will
27 affect the "bottom line" of these businesses (i.e., their ability to
28 survive), the record indicates that the impact may be severe.
29 See, e.g., Tr. 23/11982. In light of this circumstance and the
30 inherent weaknesses of the Service's cost-weight study, the

² PRC R97-1 Opinion at page 402 (emphasis added).

1 Commission finds that it should not alter Regular or ECR pound
2 rates.³

3 In *this* case, Mr. Moeller again proposes to reduce the commercial ECR pound rate
4 from its current 66.3 cents, this time to 58.4 cents. However, his proposal again lacks
5 any valid justification for doing so, nor does it even explain why this particular 3-
6 significant-digit number was chosen. It therefore should be rejected.

7 Curiously, instead of addressing the Commission's first concern about the pound rate
8 and competition, the Postal Service apparently has chosen in this proceeding to largely
9 ignore it. The Postal Service instead simply asserts that competition with private
10 enterprise competitors is no longer being offered as a justification for lowering the ECR
11 pound rate, contrary to what it said in R97-1.⁴ This approach blatantly ignores one of
12 the statutory ratemaking factors. Witness Moeller, whose testimony contains the pound
13 rate proposal, acknowledged under cross examination that he knew nothing about the
14 "alternate delivery industry."⁵ Witness Mayes reinforces those statements with a
15 professed lack of ability to assess impacts on the private sector.⁶

³ PRC R97-1 Opinion at page 403 (emphasis added).

⁴ See Moeller Testimony in Docket No. R97-1 (USPS-T-36) at 26.

⁵ For instance, Tr.10/4020 (Moeller) states, "Q: In preparing your testimony and your rate proposals in this case, did you make any inquiry or do any research as to the alternate delivery industry today? A: No."

⁶ Ms. Mayes states: "As an example, the Postal Service does not have full information regarding the prices charged by competitors. Some changes to postal rates may cause harm to those competitors, but without knowledge of the cost structure or pricing practices of the competitors, there would not have been opportunity to prevent such harm." Tr. 11/4275. She reiterates this at Tr. 11/4320 and 11/4197.

1 As to the second concern, the Postal Service has resubmitted essentially the same
2 "distribution key analysis" that it relied upon in Docket No. R97-1 with only a few
3 changes. As discussed below, neither the changes nor the distribution analysis as a
4 whole substantiate the proposed reduction in the ECR pound rate. "Moderating the
5 extent"⁷ of an unjustified reduction does not somehow make it justifiable.

6 In this case, Mr. Moeller's rate design formula has again used the same methodology
7 (e.g., same rate design formula, same discount structure, etc.) as in his rate design
8 testimony in Docket No. R97-1. His rate design proposals incorporate no new data on
9 competition or other ratemaking factors, other than the modifications purportedly based
10 on Daniel's "distribution key analysis." The one major difference between Docket No.
11 R97-1 and now is that, in this case, witness Moeller no longer offers competitive
12 response as a reason for reducing the pound rate – although, as shown below, there is
13 ample reason to believe that reducing the pound rate is entirely in line with the Postal
14 Service's competitive interests.⁸

⁷ Moeller Testimony (USPS-T-35) at 19.

⁸ See Moeller Testimony (USPS-T-35) at 19. Under cross examination, Mr. Moeller also states:

Q: From your perspective, are competitive concerns relating to the pound rate the same as they were in the R97 case?

A: I think the reasons for the proposed pound rate are as described, and you were mentioning the introduction of the cost study, and not only is it a new version of it that attempts to deal with some issues that have been in dispute in the past, my use of it also changed, and I think that was – those are the overriding reasons why this pound rate is proposed as it is.

1 When asked, witness Moeller cited four factors on which he relied to derive the specific
2 proposed rate of 58.4 cents:

3 [I]n general, factor (1) [distribution key analysis] was used to
4 confirm that indeed costs are not as weight-driven as the current
5 pound rate might suggest, and examination of costs and revenues
6 shows that the relative cost coverages for piece-rated and pound-
7 rated pieces are comparable with the proposed pound rate of 58.4
8 cents. Factors (2) [\$0.003 piece rate for pound-rated Saturation
9 nonletters] and (3) [pound rate as proxy for shape] are qualitative
10 observations about the history of the pound rate, and the
11 questionable rate relationships that exist under the current rates.
12 Factor (4) [limited impact of reduction in pound rate]
13 acknowledges the apparent sensitivity to the pound rate proposals
14 in the past and notes that the current proposed reduction is more
15 moderate.⁹

16 There is no reasonable way to conclude that these four factors can produce a pound
17 rate with *three* significant digits down to a precision measured in *mils* (a tenth of a cent).

18 As shown below, neither the "new" distribution key analysis nor any other factor justifies
19 the proposed reduction in the Standard A ECR pound rate. As a result, there is no
20 basis to deviate from the Commission's prior rejection of the Postal Service's proposal
21 to cut the pound rate. Indeed the pound rate should go up, as I explain in Section IV.

Q: Is [susceptibility to diversion to alternative media] no longer a rationale for the rate reduction?

A: Well, as I said, the previous answer, it's driven primarily by the cost. If the costs hadn't shown up the way they did, we wouldn't have proposed a lower pound rate."

Tr. 10/4007-8 (Moeller). See also Tr. 10/4018 (confirming concentrated on the cost aspect).

⁹ Tr. 10/3879 (Moeller).

1 **B. Ms. Daniel's Distribution Key Analysis Is Not Reliable And Is**
2 **Being Misused**

3 **1. Ms. Daniel's analysis is little changed from the**
4 **analysis the Postal Rate Commission dismissed In**
5 **Docket No. R97-1**

6 In Docket No. R97-1, the Commission found that a distribution key analysis nearly
7 identical to that now provided by witness Daniel did not provide an adequate
8 justification for the proposed pound rate reduction. Among the Commission's criticisms
9 were:

- 10 • "The thinness of the tallies supporting the distribution of mail
11 processing costs by weight increment represents a serious
12 problem."¹⁰
- 13 • "Another problem with the cost-weight study is that it contains no
14 comprehensive study of cost-causing factors."¹¹
- 15 • "Where the Service has failed to test these rationales or its own
16 theories, there is no sound basis on the record for distributing
17 carrier street costs to ounce increments. This is a serious
18 shortcoming as elemental load time accounts for approximately
19 one-half of city carrier street attributable cost."¹²

20 Witness Daniel admits that her current distribution is essentially the same as that
21 rejected in Docket No. R97-1. Tr. 4/1403-04. Indeed, she retained almost all of the
22 assumptions underlying the R97-1 version of the cost distribution, changing only the
23 basis for distributing elemental load costs to weight-related within shape rather than
24 volume-related within shape, while ignoring the Commission's other criticisms. Tr.
25 4/1159. Because Daniel responds to only one of Commission's criticisms of the R97-1

¹⁰ PRC R97-1 Opinion at page 400.

¹¹ PRC R97-1 Opinion at page 401.

1 distribution key analysis, there is no reason for the Commission to change its R97-1
2 conclusion that:

- 3 • "Review of the evidence suggests that the Service's cost-weight
4 study is not sufficiently reliable to support a substantial reduction
5 in the pound rate,"¹³
- 6 • "Rate reductions not firmly supported by reliable cost evidence
7 that may jeopardize the visibility [viability] of small businesses,
8 such as the alternative delivery services represented by AAPS,
9 are not consistent with 39 U.S.C. § 3622(b)(4)."¹⁴
- 10 • "The Commission finds the lack of a reliable cost-weight study to
11 be singularly frustrating. The Service has submitted the same
12 basic cost study to the Commission since 1982, despite
13 Commission requests for a more comprehensive analysis."¹⁵

14 Ms. Daniel's current distribution analysis is more of the same. Her improvement, while
15 a step in the right direction, is insufficient to cause unreliable data to become reliable.

16 ***2. Ms. Daniel herself admits her data are unreliable***

17 It is not surprising that witness Moeller does not place great reliance on the Daniel cost
18 data. Indeed, witness Daniel herself concedes that her data are so unreliable to be
19 useful only for a broad view: "They are not necessarily intended to be an exact
20 quantification of costs for every individual weight increment," but only provide "a general
21 indication of the effect weight has on total volume variable costs."¹⁶ She further notes
22 that "[t]hus, while it is possible to analyze the data for guidance in rate design, it is

¹² PRC R97-1 Opinion at page 402.

¹³ PRC R97-1 Opinion at page 399.

¹⁴ PRC R97-1 Opinion at page 403.

¹⁵ PRC R97-1 Opinion at page 402.

¹⁶ Daniel Testimony (USPS-T-28) at 3.

1 difficult, if not impossible, to isolate precisely the impact of weight on costs or identify
2 the exact unit cost of each ounce increment.”¹⁷ This is a remarkable concession for
3 testimony intended to justify a major change in the rate for pound-rated mail.

4 In fact, the problems with her distribution key analysis transcend merely its admitted
5 imprecision. More importantly, the number of tallies from which it is derived are far too
6 thin on which to base such a significant change in rate design. Witness Daniel's
7 interrogatory responses show that the number of tallies on which her cost distribution
8 relies is very low in many weight categories.¹⁸ The thinness of the tallies relates directly
9 to the confidence of her results. For ECR mail, for example, only 16 mail processing
10 and 11 city carrier in-office tallies were recorded in the 11-13 oz. range. Barely 100
11 tallies were recorded for city carriers in-office, and under 200 for mail processing, above
12 7 ounces.¹⁹

13 Thinness of tallies is a pervasive problem in the Daniel distribution key analysis. It is
14 important to note that, contrary to certain suggestions thus far in this case, if the Daniel
15 distribution were considered at all there would be no basis for removing the tallies
16 recorded at the 15-16 ounce weight category.

¹⁷ Daniel Testimony (USPS-T-28) at 4.

¹⁸ See, e.g., Tr. 4/1330-1332 (Daniel discussing First Class Single Piece), 1333-1335 (discussing First Class Presort), 1342-1344, 1306-1309 (discussing ECR).

¹⁹ Tr. 4/1344 (Daniel).

1 First, more tallies were recorded at that weight level than at lesser weights.²⁰ Thus the
2 cost numbers in the 15-16 ounce weight category for ECR have greater support than
3 those in many of the other heavy weight increments. Ms. Daniel suggested on cross-
4 examination that the higher unit costs observed at the 15-16 ounce may be due to the
5 influence of factors other than weight (e.g., transportation costs),²¹ but this makes no
6 sense. Her own data show increased mail handling costs to be the source.²²

7 Closer examination of the rate schedules further suggests that at least part of the
8 reason for high datapoints at higher weight levels is a discontinuity in rates between
9 Standard A and Standard B. At 15-16 ounces and below, pieces are much cheaper to
10 mail as Standard A than pieces weighing slightly over sixteen ounces, which must be
11 mailed parcel post. This creates an incentive for mailers to lighten their pieces slightly
12 to obtain a lower rate. This effect may result in more tallies in the 15-16 ounce range,
13 which Ms. Daniel's analysis would suggest are very high cost pieces.

14 Furthermore, as shown in the figures below, all of the Standard A subclasses show
15 rapidly increasing costs at the highest weights. The fact that every subclass shows this
16 same pattern implies that it is not simply the result of sampling error arising from the low
17 volume of traffic at the highest weight bracket, as the Postal Service intimates.²³ If it
18 were sampling error, I would expect to see some subclasses to have very high costs

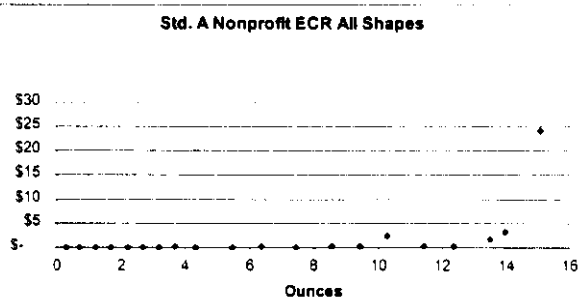
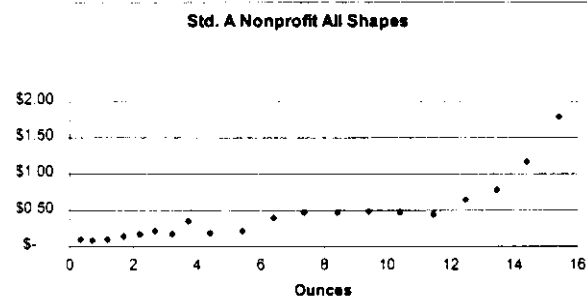
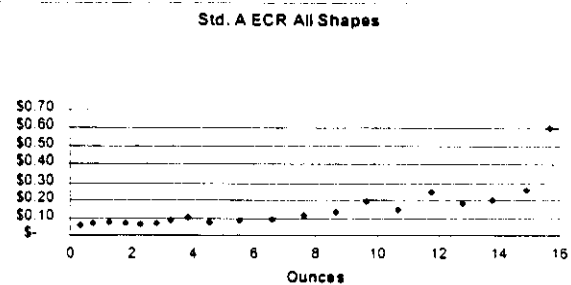
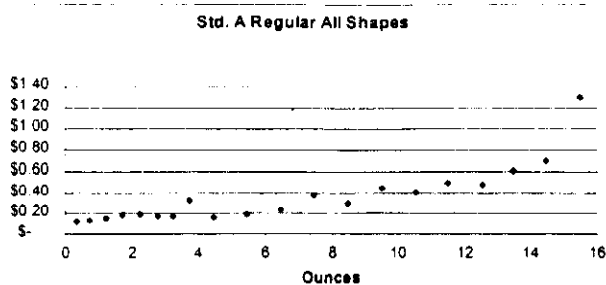
²⁰ See Tr. 4/1306-1309, 1342-1344 (Daniel).

²¹ See Tr. 4/1292-1293 (Daniel).

²² See Library Reference USPS-LR-I-92, Section 2.

²³ See Tr. 4/1293-1294 (Daniel).

- 1 and some subclasses to have very low costs in the 15-16 ounce weight category.
- 2 Instead, all four subclasses have very high costs.



Source: USPS-LR-I-92.²⁴

Moreover, Ms. Daniel's data yield anomalous results. Anomalies exist within and across the cost data for subclasses. For instance, ECR parcels apparently cost only one-third as much as Nonprofit ECR parcels,²⁵ while Nonprofit ECR parcels apparently cost more than four to seven times as much as lighter ECR parcels.²⁶

²⁴ Note: The vertical scale for each graph is set to optimally display the points in each graph. The fact that the scales vary so dramatically is a further indication of how anomalous witness Daniel's data are.

²⁵ See Daniel Testimony (USPS-T-28), Table 3. Nonprofit ECR parcels average \$2.4946, ECR parcels average \$0.8242.

²⁶ See Daniel Testimony (USPS-T-28), Table 3. Nonprofit ECR parcels under 3.0 ounces average \$4.4242 to send, while ECR parcels under 3.0 ounces average only \$0.9441 to send (roughly one quarter as much). Nonprofit ECR parcels under 3.5

1 Daniel states that the Nonprofit results "could be the result of a variance due to the
2 difficulties associated with estimating and calculating unit costs for small volume
3 categories."²⁷ However, it would be more precise to note that the problem arises from
4 the small number of tallies recorded for *both* subclasses.

5 Finally, as witness Daniel concedes: "Isolating the effect of weight on cost is very
6 difficult because weight is rarely the only characteristic that varies between different
7 mail pieces. The shape, origin/destination combination, cube, and level of presorting
8 and dropshipping of mail can affect the cost of mail."²⁸ Even when she attempts to
9 control for worksharing and Basic/High Density/Saturation differences (at Tr. 4/1209-
10 1220 and 1351-1359), she cannot sufficiently control for the other factors that vary
11 across weight. Data which are offered only as a "general indication of the effect weight
12 has on total volume variable costs"²⁹ cannot justify major ECR rate design restructuring
13 as witness Moeller has done, particularly when the results are as sensitive to
14 assumptions as they are here.

15 **3. Ms. Daniel's regression analyses are not useful**

16 Although she does not endorse them, witness Daniel includes in her analysis several
17 regressions generated by the Excel spreadsheet program. These regressions, which
18 gave rise to some discussion during her cross-examination, use observations for piece-

ounces average \$4.8351 to send, while ECR parcels under 3.5 ounces average only \$0.6948 to send (roughly one seventh as much).

²⁷ Tr. 4/1229-1230 (Daniel).

²⁸ Daniel Testimony (USPS-T-28) at 3, lines 24-27.

1 rated pieces to establish the incremental costs per ounce of pound rated mail. Putting
2 aside for the moment my concerns over the reliability of the data, for the sake of
3 argument I here consider whether these, and various proposed adjustments, make any
4 sense.

5 First, including observations for piece-rated pieces to establish the incremental costs of
6 pound-rated mail produces a mismatch of costs with the breakpoint rate schedule.
7 Since the pound-rate applies only to material weighing 3.3 ounces and above, including
8 pieces weighing less than 3.3 ounces in a regression to determine a pound rate makes
9 no sense, unless one were interested in "cooking" the data to justify a lower pound rate.

10 Second, Ms. Daniel attempts to improve her unweighted regressions by combining
11 weight categories in order to weight the tallies differently. She states that the
12 regressions where the weight categories are combined are better than the detailed
13 regressions. However, this combining of categories is not grounded in statistical theory.
14 Detailed and combined regressions should give consistent results only where the
15 underlying data are linear. But ECR cost data are not linear. So her justification that
16 the combined results are "more useful" since they "give each data point more equal
17 weight" makes no sense. Combining heaviest weight increments increases the number
18 of observations in those weight categories but further obscures the steep curvature at
19 the highest weights.

²⁹ See Daniel Testimony (USPS-T-28) at 3, line 22.

1 Claims by Postal Service witnesses that they did not rely on regression analysis
2 because of the variability of the volume distribution over weight increments ring
3 hollow.³⁰ In fact, witness Daniel *does* use weighted regression to justify rate design in
4 the Periodicals subclass.³¹ This inconsistency is another example of using analyses to
5 cherry pick the results.

6 **C. Mr. Moeller's Cost Coverage "Test" For Piece-rated And Pound-**
7 **rated ECR Mail Does Not Provide A Reliable Basis For Reducing**
8 **The ECR Pound Rate**

9 Using his cost coverage "test," witness Moeller claims that his pound-rate proposal for
10 ECR has the effect of reducing an apparent disparity in cost coverage between piece-
11 rated and pound-rated pieces. For example, using 3.0 ounces as the dividing line, his
12 "test" gives a before-rates cost coverage of 200.8% for piece-rated mail versus 215.5%
13 for pound-rated mail, and an after-rates cost coverage of 215.6% versus 216.1%.
14 Against this backdrop, Mr. Moeller then observes that his ECR rate proposal appears to
15 reduce the difference in cost coverage.³² See the table below, based on the table in
16 witness Moeller's Testimony at 21.

³⁰ See Tr. 12/4760 (Fronk) and 4/1292-1296 (Daniel).

³¹ See Daniel Testimony (USPS-T-28) at 18.

³² Results using 3.5 ounces as the dividing line are similar.

Cost Coverages for Piece-rated vs. Pound-rated Standard A ECR						
	Before Rates			After Rates		
	Unit Revenue	Daniel's Unit Cost	Implicit Coverage	Unit Revenue	Daniel's Unit Cost	Implicit Coverage
Using costs with a 3.0 ounce dividing line						
Piece-rated	0.13312	0.0663	200.8%	0.14295	0.0663	215.6%
Pound-rated	0.19419	0.0901	215.5%	0.19472	0.0901	216.1%
Difference			-14.7%			-0.5%
Using costs with a 3.5 ounce dividing line						
Piece-rated	0.13312	0.0676	196.9%	0.14295	0.0676	211.5%
Pound-rated	0.19419	0.0916	212.0%	0.19472	0.0916	212.6%
Difference			-15.1%			-1.1%
Source: Moeller Testimony (USPS-T-35) at 21.						

Mr. Moeller concludes: "In this instance, estimates of implicit coverage can be illuminating."³³ However, Mr. Moeller apparently finds comparisons of implicit cost coverage "illuminating" only when they happen to support his rate proposals. He does not perform the test for any other subclass, even though he states: "It is appropriate to use available information to better align rate components with their underlying cost."³⁴

In fact, applying the same test to Standard A Regular and First Class Single Piece yields results that are inconsistent with Postal Service rate proposals. Mr. Moeller as much as admits to cherry picking the ECR result: "It is not required that the cost coverages of any particular subgroups be equated; however, at times comparing these

³³ Moeller Testimony (USPS-T-35) at 20, n. 39.

³⁴ Tr. 10/3922 (Moeller).

coverages can help establish more appropriate rate relationships.”³⁵ I discuss these comparisons in turn.

1. The same cost coverage “test” for Standard Regular has implications inconsistent with Mr. Moeller’s proposal

Applying the same implicit cost coverage comparison to Standard A Regular mail results in a before-rates cost coverage of 124.6% for the piece-rated pieces and 119.0% for the pound-rated pieces, using 3.0 ounces for the dividing line. This is a 5.6 percentage point difference. Equalizing these cost coverages would require, *ceteris paribus*,³⁶ an increase in the Regular pound rate. However, witness Moeller proposes a decrease in the Regular pound rate of 1.6 cents, from 67.7 cents to 66.1 cents.

His resulting after-rates cost coverages are 136.7% for the piece-rated pieces and 127.7% for the pound-rated pieces, a 9.1 percentage point difference. Thus, in contrast to his ECR proposal, Moeller’s current proposal to cut the pound rate for Standard Regular actually *increases* the difference between the piece-rated and the pound-rated cost coverage.³⁷ Trends using 3.5 ounces for the dividing line are similar. See the table below.

³⁵ Tr. 10/3922 (Moeller).

³⁶ *Ceteris paribus* means “holding all other things constant.”

³⁷ Note that technically, Mr. Moeller’s proposal is not “*ceteris paribus*” with respect to the pound rate, as rate elements other than the pound rate have changed as well. However, the fact remains that his proposal, of which the pound rate is a part, has increased the apparent disparity in cost coverages.

**Cost Coverages for Piece-rated vs. Pound-rated
Standard A Regular**

	Before Rates			After Rates		
	Unit Revenue	Daniel's Unit Cost	Implicit Coverage	Unit Revenue	Daniel's Unit Cost	Implicit Coverage
Using costs with a 3.0 ounce dividing line						
Piece-rated	0.17833	0.1431	124.6%	0.19566	0.1431	136.7%
Pound-rated	0.30322	0.2547	119.0%	0.32519	0.2547	127.7%
Difference			5.6%			9.1%
Using costs with a 3.5 ounce dividing line						
Piece-rated	0.17833	0.1452	122.8%	0.19566	0.1452	134.8%
Pound-rated	0.30322	0.2816	107.7%	0.32519	0.2816	115.5%
Difference			15.1%			19.3%

Source: Daniel Testimony (USPS-T-28) Table 3, Tye Workpapers

Clearly, the only real consistency in witness Moeller's justification for rate design in the commercial subclasses of Standard (A) Mail is that the pound rate in each subclass goes down.

2. Cost coverage "tests" for First Class Single Piece mail have implications inconsistent with Mr. Frank's proposals

The Postal Service's inconsistency is not confined to Standard A mail. Applying the same comparison to First Class Single Piece mail, classifying 1 ounce pieces as "piece-rated" and greater than 1 ounce pieces as "pound-rated," gives a before-rates cost coverage for one-ounce pieces of 164.7% and a cost coverage for heavier pieces of 185.0%. See the table below.

Cost Coverages for Piece-rated vs. Pound-rated First Class Single Piece						
	Before Rates			After Rates		
	Unit Revenue	Daniel's Unit Cost	Implicit Coverage	Unit Revenue	Daniel's Unit Cost	Implicit Coverage
Piece-rated	0.33342	0.2024	164.7%	0.34350	0.2024	169.7%
Pound-rated	0.94007	0.5082	185.0%	0.97556	0.5082	192.0%
Difference			-20.2%			-22.3%
Source: Tye Workpapers.						

This could call for a *reduction* in the extra ounce charge to bring the cost coverages closer together. However, the Postal Service has actually proposed a 1 cent increase in the extra ounce charge from 22 cents to 23 cents. The Postal Service's proposal increases the differential in cost coverage from 20.2 percentage points to 22.3 percentage points.

3. Witness Moeller does not apply his cost coverage "test" to nonprofit subclasses

In addition to the above examples, it should be noted that the cost coverage comparison is not discussed at all for Standard A Nonprofit ECR. In the Nonprofit ECR subclass, witness Moeller has proposed an increase in the pound rate.

It is interesting to observe that the Postal Service also estimates the own-price elasticity of Nonprofit ECR mail estimates to be -0.162,³⁸ indicating a relatively inelastic demand and that there may be fewer competitive threats to the Postal Service. Thus, it would appear that the Postal Service is proposing pound decreases in more competitive

³⁸ Tolley Testimony (USPS-T-6) at 148.

1 Standard A subclasses, and pound rate increases in what are perceived to be less
2 competitive Standard A subclasses. Although he denies any competitive rationale for
3 his proposed pound rate changes, his proposals certainly conform to a pattern of a
4 "stealth" competitive reductions.

5 It is readily apparent that witness Moeller presents the cost coverage comparison as
6 evidence for a reduction in the ECR pound rate only when it coincidentally "illuminates"
7 results that appear to support his proposal. Consistent application of the test across
8 the rate proposals of witnesses Moeller and Fronk would give wildly different
9 implications for the extra ounce and pound rates. Since Postal Service witnesses do
10 not consistently use this test to support their rate proposals, the cherry-picked ECR cost
11 coverage cannot be a reliable basis for rate design.

12 ***D. Postal Service Witnesses Use Inconsistent Approaches To***
13 ***Setting Rates For Heavier Mail***

14 Witness Fronk's proposals for the extra ounce in First Class mail and witness Moeller's
15 proposed pound rate reductions in commercial Standard A stand in stark contrast to
16 each other and illustrate the *ad hoc* nature of the Postal Service's approach to pricing
17 heavier mail. There is no consistent approach; rather, data and analyses are
18 expediently structured to support proposals. The rate proposals conform to a pattern of
19 an enterprise seeking to use rate levels and rate design to shift volume from private
20 enterprise competitors and to finance these rate structures with revenues from mail
21 legally protected from competition.

1 Witness Daniel, in fact, admits outright that the cost analysis followed the needs of the
2 rate design witnesses.³⁹ Her presentation of cost estimates by weight reflect this
3 approach as well. Indeed, Ms. Daniel agreed under cross examination that she
4 calculated the "additional" unit costs for First Class and Standard A mail in inconsistent
5 manners.⁴⁰ For witness Taufique she relies on a regression analysis, an approach she
6 rejects in the other subclasses. The choice of these different approaches is consistent
7 with a seeming predetermination to raise First Class extra ounce rates and lower ECR
8 pound rates.

9 Once they received Ms. Daniel's data, witnesses Fronk and Moeller proceeded to
10 calculate the incremental costs of heavier mail inconsistently between First Class and
11 Standard A mail. For First Class mail, witness Fronk computes the incremental cost
12 and incremental revenues for all ounces above the basic one ounce rate (thereby
13 ignoring the revenues and costs from the first ounce of First Class).⁴¹ Thus, Mr. Fronk's
14 cost coverage comparison consists of dividing the unit cost for the additional ounces
15 (12.7 cents) into the additional ounce rate (23 cents), and comparing that markup (81
16 percent) to the overall subclass coverage of 96 percent.⁴² In contrast, for Standard A
17 ECR mail witness Moeller looks at all revenues (including per piece rates) and all

³⁹ For instance, in noting why a particular analysis was not performed, she states:
"This type of analysis was not required by the First-class rate design witness." Tr.
4/1323; see also Tr. 4/1168-1169, 1416 (Daniel).

⁴⁰ Tr. 4/1419 (Daniel).

⁴¹ For example, at Tr. 12/4874 (Fronk): "Q: Is it correct that you only used the Daniel
study to get an average cost per ounce for letters from 2 ounces to 11 ounces? A: I
used the data in the Daniel study in the aggregate, that's correct."

weight-related costs on separate sides of the "breakpoint."

III. THE POSTAL SERVICE DOES NOT JUSTIFY ITS PROPOSAL TO LOWER THE COST COVERAGE FOR COMMERCIAL ECR MAIL

The Postal Service, through the testimony of witness Mayes, proposes to reduce the cost coverage of Standard A ECR mail from that set by the Commission in Docket No. R97-1. In particular, the Postal Service has proposed to set the cost coverage of ECR at 208.8%, resulting in a 4.9% average rate increase.⁴³

As I will show, this proposal is not well supported and gives rise to undesirable anomalies in rate design for both the Standard A commercial Regular and ECR subclasses. Witness Mayes's proposed cost coverage represents a relative decline from the level set in Docket No. R97-1 when normalized to account for the changes in cost attribution methodology between the two cases and between the Commission and Postal Service, as the USPS itself shows through the testimony of witness Bernstein. In fact, I show below that the actual cost coverage in the test year under the Postal Service's rate proposals for ECR will actually be even less than Ms. Mayes's estimates.

Witness Mayes's basic justification for reducing the ECR cost coverage is her conclusion that the existing ECR coverage is too high. She proposes increases for ECR that are less than the system average in order to "[reflect] a desire to lower the

⁴² Fronk Testimony (USPS-T-33) at 25.

⁴³ See Mayes Testimony (USPS-T32) at 38, lines 4-8.

1 very high cost coverage of this subclass.”⁴⁴ However, she has since retreated from the
2 only objective consideration she could offer as to why ECR coverages should be
3 reduced. Moreover, she has completely ignored another measure – unit cost
4 contribution – that shows that ECR would continue to make a far smaller contribution
5 than First Class mail.

6 Moreover, reducing the cost coverage for ECR mail has the undesirable side-effect of
7 aggravating a number of anomalies in the rate design of not only Standard ECR mail
8 but also Standard Regular mail. This state of affairs appears to arise from a
9 “compartmentalization” of responsibilities among the pricing and rate design witnesses.
10 Witness Moeller places the blame for the rate anomalies on a professed necessity to
11 live within the constraint of the cost coverages he was ostensibly given by witness
12 Mayes. She, in turn, claims that curing the anomalies are Mr. Moeller's responsibility,
13 since he is the rate design witness. As a consequence of this compartmentalization,
14 nobody takes responsibility for creating—or correcting—the resulting anomalies. In the
15 process, the Postal Service appears to have abandoned its use of ECR cost coverages
16 as a tool to manage the desired rate relationships between the ECR and Regular
17 subclasses.

18 The simple solution to the Postal Service's compartmentalization problem is for the
19 Commission to raise the cost coverage for ECR so that arbitrary anomalies are not
20 imposed on rate design of the Standard A subclasses.

⁴⁴ See Mayes Testimony (USPS-T-32) at 38, lines 7-8, 20-21 and Tr. 11/4324-4325

1 **A. The Postal Service Is Proposing A Decrease In The Cost**
2 **Coverage Of ECR Mail**

3 Witness Mayes at times appears confused as to whether she is, in fact, proposing to
4 reduce the cost coverage of ECR mail. This confusion arises from the Postal Service's
5 proposal to change the volume variability of large segments of costs, which results in
6 increasing the overall system-wide cost coverage. Ms. Mayes does ultimately,
7 however, concede that "the cost coverage being proposed in this case represented a
8 higher markup but a lower markup index than did the Commission's recommendation in
9 Docket No. R97-1."⁴⁵

10 In fact, the Postal Service's proposals do represent a material reduction in cost
11 coverage when compared with the Commission's R97-1 recommended markup, as the
12 Postal Service's own direct case shows. The table below provides data from Library
13 Reference USPS-LR-I-149 sponsored by witness Bernstein.⁴⁶ Column A gives the cost
14 coverages recommended by the Commission in Docket No. R97-1. Column C gives
15 the cost coverages proposed by Postal Service witness Mayes, which "[reflect] Postal
16 Service costing methodologies at the Postal Service's R2000-1 proposed rates."⁴⁷
17 Column B gives "normalized" cost coverages "reflecting PRC costing methodologies at

(Mayes).

⁴⁵ See Tr. 11/4335-4336 (Mayes).

⁴⁶ While the figures were calculated by witness Bernstein, I do not endorse his proposals concerning Ramsey pricing. See Appendix B.

⁴⁷ USPS-LR-I-149.

the Postal Service's R2000-1 proposed rates."⁴⁸ Columns A and B provide an apples-to-apples comparison, as both those columns use a consistent costing methodology.

Cost Coverages

	PRC Recommended Cost Coverage using PRC Methodology R97-1 (A)	USPS Proposed Cost Coverage, using PRC Methodology R2000-1 (B)	USPS Proposed Cost Coverage, using USPS Methodology R2000-1 (C)
Standard Mail A			
Regular	134.6%	122.5%	132.9%
Enhanced Carrier Route	203.0%	195.8%	208.8%
Total Mail & Services	155.3%	154.2%	168.0%

Source: USPS-LR-I-149.

This readily shows that the Postal Service's proposed ECR rates in fact have a lower cost coverage than recommended by the Commission in Docket No. R97-1, when properly normalized. This result is consistent with the Postal Service's explicit desire to reduce ECR cost coverage, which it believes to be too high.

At the same time, the Postal Service is proposing to shift more of the institutional cost burden to a monopoly subclass (First Class) from a competitive subclass (ECR).

Ms. Mayes confirms that First Class markup index is going up at Tr. 11/4347-48 (Mayes). She argues "the shift of some of this institutional burden to First-Class Mail, particularly in view of the relatively small increase in First-Class Mail rates, was not viewed as unfair." Tr. 11/4350 (Mayes). Note that the effect of this shift is that the First

⁴⁸ USPS-LR-I-149.

1 Class share of non-volume variable costs has increased from the Postal Service's R97-
2 1 proposal of 62 percent to the current proposal of 64 percent. Tr. 11/4351 (Mayes).
3 This shifting of the institutional cost burden to a monopoly class is unjustified, and is
4 something this Commission should not tolerate.

5 **B. The Low Proposed ECR Cost Coverage Creates Serious Rate**
6 **Design Anomalies, As The Postal Service Tries To Maintain**
7 **Desired Rate Relationships**

8 As noted above, despite recognizing the importance of establishing rate relationships
9 that account for migrations across rate categories and encourage efficient mailer
10 worksharing, witness Moeller proposes numerous rate anomalies that violate these
11 principles.

12 Mr. Moeller claims that the anomalous passthroughs that he proposes are unavoidable
13 consequences of adhering to the cost coverages which he takes as given from Witness
14 Mayes.⁴⁹ In fact, the low cost coverage for ECR together with a desire to provide a
15 proper incentive for ECR Basic Mail to convert to 5-digit Regular Automation mail make
16 it impossible in this proposal to implement a rational discount structure for Standard A
17 mail based on presort tiers.

18 **1. *Witness Moeller incorrectly blames the passthrough***
19 ***anomalies on a need to maintain desired rate***
20 ***relationships***

21 Mr. Moeller has proposed some passthroughs in this case that are simply astounding.
22 The table on the next page shows witness Moeller's proposed passthroughs in R97-1,

⁴⁹ See Tr. 10/3861-3862 (Moeller).

the Commission's recommended passthroughs, and witness Moeller's current proposed passthroughs.

Of note are the Flat automation 3/5 digit passthrough of 500% and the Flat automation Basic passthrough of 230%. Also note that Mr. Moeller's ECR Letters/Nonletters Basic passthrough continues to be 0%. That his proposed passthroughs vary from 0% to 500% completely undercuts the idea that costs are driving the rate design.⁵⁰

Passthrough Category	PRC		
	Moeller R97-1 Proposed	Recommended Decision, R97-1	Moeller R2000-1 Proposed
Regular			
Letters/Nonletters Basic	40.0%	50.0%	77.0%
Letters/Nonletters 3/5-digit	40.0%	40.0%	64.0%
Letter presort 3/5-digit	165.0%	100.0%	95.0%
Letter automation Basic	140.0%	100.0%	110.0%
Letter automation 3-digit	130.0%	100.0%	100.0%
Letter automation 5-digit	120.0%	100.0%	100.0%
Flat automation Basic	100.0%	100.0%	230.0%
Flat automation 3/5-digit	100.0%	100.0%	500.0%
Destination entry BMC	80.0%	85.0%	73.0%
Destination entry SCF	80.0%	85.0%	77.0%
ECR			
Letters/Nonletters Basic	0.0%	0.0%	0.0%
Letters/Nonletters high density	35.0%	65.0%	65.0%
Letters/Nonletters saturation	35.0%	95.0%	95.0%
Letter high density	100.0%	100.0%	125.0%
Letter saturation	100.0%	100.0%	100.0%
Letter automation	110.0%	100.0%	100.0%
Destination entry BMC	80.0%	85.0%	73.0%
Destination entry SCF	80.0%	85.0%	77.0%
Destination entry DDU	80.0%	85.0%	77.5%
Source: Tr. 10/3908-3909 (Moeller).			

⁵⁰ In fact, witness Moeller (at Tr. 10/3871) dismisses costs as a rate design objective.

Q: Was one of the objectives to move towards a rate design incorporating 100% passthrough of cost differences?

A: Not in particular, although that is not necessarily an unworthy objective.

1 It is clear that the Regular Mail passthroughs are driven—understandably—by the
2 desire to have qualified letter mail submitted at Regular automation rates rather than
3 ECR Basic rates. This leads to passthroughs that vary considerably from the optimal.
4 Moeller states: “At the 3-digit tier, a passthrough of 106 percent is selected. This leads
5 to a discount that is a modest 1/10th of a cent greater than the calculated savings, but
6 helps achieve the desired 5-digit automation rate relationship with ECR Basic.”⁵¹
7 (These affected categories are highlighted in the table above.) He also testifies: “The
8 passthrough at the 5-digit automation tier is 160 percent. This passthrough is
9 principally based on achieving the desired rate relationship with ECR Basic letters.”⁵² In
10 other words, Moeller admittedly inflates the passthrough (and thus lowers the rate) in
11 the Regular subclass in order to achieve the desired diversion from ECR.

12 Moeller further states, concerning the Basic tier of ECR Mail, that a “zero percent shape
13 passthrough at the Basic tier, coupled with rate distinctions for letters at the other tiers,
14 was an attempt to balance the Commission’s concern for recognition of cost differences
15 while giving special consideration to the Postal Service’s concern regarding its letter
16 automation program.”⁵³ Thus, this important ECR passthrough was set to zero in order
17 to achieve the desired rate relationship with the automation rate in Standard A Regular.

⁵¹ Moeller Testimony (USPS-T-35) at 11, lines 21 through page 12, line 1.

⁵² Moeller Testimony (USPS-T-35) at 12, lines 3-5. Moeller confirms this usage of passthroughs: “The passthrough for the 5-digit automation discount was the principal tool used to create the rate relationship.” Tr. 10/3869 (Moeller).

⁵³ Moeller Testimony (USPS-T-35) at 24, line 17 through page 25, line 1.

1 The root causes of these rate anomalies are (1) the desire to maintain certain rate
2 relationships, such as the desire to encourage migration of certain automation-
3 compatible ECR basic letters to the 5-digit Regular Automation rate and (2) the
4 apparent compartmentalization of responsibility between witness Mayes (who
5 addresses cost coverage and overall percentage rate increase) and witness Moeller
6 (who addresses rate design). This compartmentalization causes a failure to account
7 properly (from an economic point of view) for important statutory ratemaking factors and
8 desirable principles of rate design.

9 Apparently neither witness considered the possibility of raising the ECR cost coverage
10 so that severe rate anomalies are not required. Witness Mayes notes at Tr. 11/4294
11 that there was "some attention paid" to the cross-over problem but further notes at Tr.
12 11/4324-4325 that it did not "restrict development of cost coverages . . . independently
13 of each other." Moeller certainly doesn't consider this possibility either.⁵⁴

14 In short, passthrough percentages varying from 0 to 500% were imposed ostensibly to
15 accommodate witness Mayes's proposed reduction in the ECR cost coverage, yet
16 maintain desired rate relationships. The failure even to consider adjusting cost
17 coverages to eliminate the passthrough anomalies is a serious omission.

⁵⁴ Tr. 10/3830. He notes that the cost coverage is a constraint but does not consider raising it. Tr. 10/3875 & 3887.

1 **2. The low Standard A ECR cost coverage creates other**
2 **distortions in the rate design**

3 The lower cost coverages in ECR and the proposed cut in the commercial Standard A
4 ECR pound rate create other distortions by causing a “push up” in other rate cells that
5 require constraints on rates to avoid “rate shock.” In addition, due to linkages in
6 discounts within the “presort tree,” distortions caused by one rate anomaly propagate
7 throughout the Standard A rate design. Some examples of these consequences are
8 given by witness Moeller:

- 9 • “Even if the study were to indicate that a greater reduction in the [Regular]
10 pound rate is justified, such a reduction would result in an increase in the
11 piece rates beyond that proposed, and would be outweighed by the
12 competing objective of tempering the percentage increase for individual
13 categories.” USPS-T-35 at 9. “[C]onsideration of the upward effect on the
14 [Regular] piece rates led me to limit the reduction to a modest 1.6 cents.” Tr.
15 10/3873 (Moeller).
- 16 • “Any further reduction in the [ECR] pound rate may have led to undesirable
17 increases in the piece rate.” Tr. 10/3879 (Moeller).

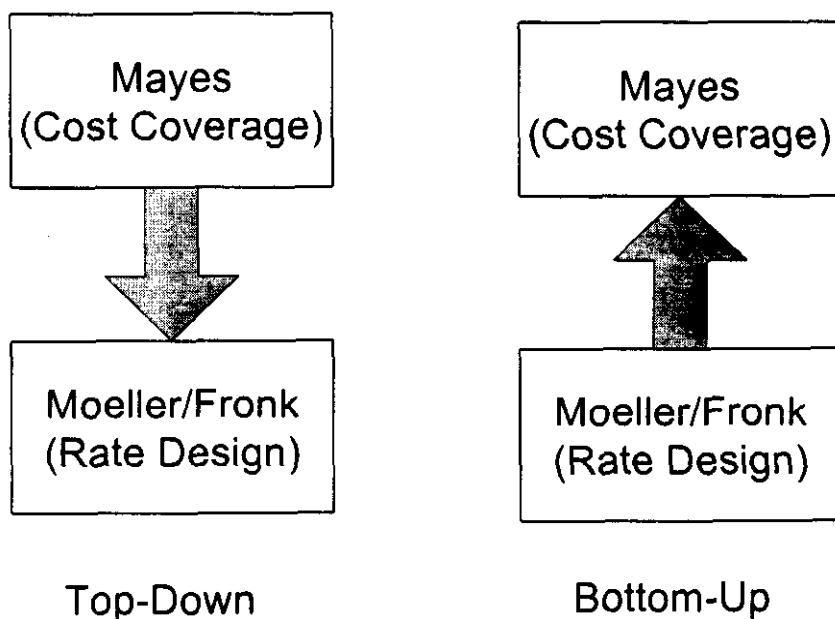
18 **C. The Postal Service Tries To Avoid the Issue Of Justifying A**
19 **Lower Cost Coverage For ECR Mail By “Compartmentalizing”**
20 **Responsibilities Between Witnesses Moeller And Mayes**

21 Witness Moeller claims to address only matters of rate design within the overall
22 constraints of rate levels, as determined by the cost coverages, which he professes to
23 be powerless to affect. Mr. Moeller also claims that several elements of the rate design,
24 including rate anomalies and his proposed cut in the pound rate, are an unavoidable
25 consequence of the cost coverages.

26 Witness Mayes, in turn, claims that matters such as migrations among subclasses are
27 matters for rate design. She does not consider it her responsibility to explicitly consider

1 whether such rate anomalies could be best solved by changes in cost coverages and
2 rate levels.⁵⁵

3 I shall refer to the ratemaking process as described by the Postal Service witnesses as
4 "top down." This version of the Postal Service's process starts with target cost
5 coverages determined by witness Mayes, followed by witness Moeller designing rates
6 given the target cost coverages as constraints. I suggest, however, that the real
7 process was a bottom up process, where the Postal Service first determined the rate
8 levels it desired, and then derived the cost coverages necessary to achieve that result:



9
10 All the evidence points to this conclusion.⁵⁶ It appears that Mr. Moeller voluntarily
11 selected the four digit ECR cost coverage necessary to achieve his rate level goals,

⁵⁵ See Tr. 11/4324-4325.

⁵⁶ See Tr. 10/3858-64 (Moeller).

1 and then justified the resulting rate anomalies and the reduced pound rate as being
2 required by the cost coverage constraint. Witness Mayes then endorsed Mr. Moeller's
3 cost coverages using almost the same language as witness O'Hara in the last
4 proceeding.⁵⁷ It is interesting to note that the resulting rate proposals are entirely
5 consistent with a desire to divert volume from private enterprise competitors.

6 If we assume, to the contrary, that the actual decision-making of the Postal Service
7 followed the "top down" approach as described by Postal Service witnesses, the cost
8 coverage "targets" were handed down from Mr. Mayes to Mr. Moeller. If the process
9 happened exactly as described by the Postal Service, witness Mayes (1) failed to
10 consider the rate anomalies imposed on witness Moeller by her recommended rate
11 levels and target cost coverages and (2) further failed to correct them.

12 **D. There Is No Valid Justification For A Reduction In The ECR Cost**
13 **Coverage**

14 Witness Mayes's testimony in this proceeding is virtually identical—often word for
15 word—to that of Dr. O'Hara's in the last proceeding. Yet Dr. O'Hara recommended a
16 much higher ECR cost coverage. The Postal Service has not given any justification for
17 a reduction in the ECR cost coverage, other than a subjective belief that the ECR cost
18 coverage is "too high" and an alleged increase in demand elasticity.

19 When asked to provide information that represents any changes in circumstances or
20 facts between the Commission's decision in Docket No. R97-1 regarding Standard Mail

⁵⁷ Compare O'Hara Testimony, docket No. R97-1 (USPS-T-30) at 34-36 with Mayes

1 (A) and ECR and the time she prepared her direct testimony, witness Mayes was
2 unable to cite any new data or studies except an alleged change in estimated demand
3 elasticity.⁵⁸

4 However, as witness Thress's interrogatory responses show, the alleged increase in
5 demand elasticity is due to a change in demand equation specification, and not to any
6 structural change in ECR demand. Performing an apples-to-apples comparison by
7 estimating the same equation using the same data with the only difference being
8 different time periods, witness Thress finds no meaningful difference in the ECR
9 demand elasticity.⁵⁹ He actually performs two sets of apples-to-apples comparisons,
10 one using the old data and the old specification, and the other using the new data and
11 new specification. Both sets of results show no significant difference. Ms. Mayes has
12 since concurred, and has stated that she now does not believe that the purported

Testimony, Docket No. R2000-1 (USPS-T-32) at 38-40.

⁵⁸ Tr. 11/4322 (Mayes).

⁵⁹ He states:

The estimated own-price elasticity of Standard ECR mail using the R97-1 demand specification, estimated using a sample period through 1999Q4, using the econometric methodology employed in my current testimony, is -0.599."

Tr. 9/3780.

This value is nearly identical to the -0.598 he estimated in Docket No. R97-1. Using the specification he proposes in Docket No. R2000-1, he finds that "if one estimates the current ECR demand equation using a sample period ending in 1997Q2 (as was done in R97-1), the estimated own price elasticity for Standard ECR mail is estimated to be equal to -0.768, which is not very different from my current estimate of -0.808. Tr. 9/3773 (Thress).

1 difference in elasticity is statistically significant.⁶⁰ Thus, the Postal Service has now
2 abandoned the only objective justification that the Postal Service relied upon for
3 reducing the cost coverage.

4 **E. The Postal Service's ECR After-Rates Cost Coverage Is**
5 **Overstated**

6 As shown above, the Postal Service's own data show that ECR cost coverage will
7 actually go down, contrary to its efforts to demonstrate otherwise. The Postal Service's
8 data actually overstate ECR cost coverage because the denominator of the cost
9 coverage ratio is deflated and the numerator is inflated. The Postal Service also has
10 underestimated FY1999 costs, suggesting that the cost coverage would be lower than
11 forecast in the Test Year at proposed rates.

12 **1. The Postal Service understates Test Year ECR**
13 **costs**

14 The Postal Service's cost methodology understates costs relative to the Commission's
15 cost methodology. Restating the cost coverage at the Postal Service's proposed rates
16 using the Commission's cost methodology therefore gives a lower figure for the ECR
17 cost coverage. Were the Postal Service to use its incremental cost measure to
18 calculate the ECR cost coverage at its proposed rates, the resulting cost coverage
19 would also be lower than that proposed by the Postal Service.⁶¹

⁶⁰ VP-CW/USPS-T32-16.

⁶¹ See Kay Testimony (USPS-T-23) at page 22, Table 1A. ECR incremental cost for TY2001 is greater than ECR volume variable cost for both before-rates and after-rates.

Moreover, the 1999 Cost and Revenue Analysis shows the Postal Service underestimated FY99 ECR costs by 4.62%.⁶² In contrast, Standard A Regular costs were actually overestimated by 4.64%.⁶³ While I have not calculated the full impact of the results in the 1999 Cost and Revenue Analysis, it is clear that there is an error in the 1999 forecast. If this same error is rolled forward into the test year, then it is clear that the Postal Service's proposed cost coverage will not be achieved at the rates proposed by witness Moeller. Instead, ECR rates would have to be raised over and above the Postal Service's proposals to achieve that coverage.

2. The Postal Service overstates Test Year ECR revenues

Witness Mayes further overstates the Postal Service's proposed ECR cost coverage because the projected revenues used in the test year (the numerator) are overstated. The Postal Service fails to account for shifts in the distribution mail volume (the "billing determinants") due to proposed changes in rate design (*i.e.*, increased per-piece rates and reduced per-pound rates). As a result, it overestimates the percentage increase in ECR revenues per piece that will be realized at its proposed rates in the test year.

While one might argue that it is "standard practice" for the Postal Service to ignore shifts in the billing determinants in the test year due to changes in rate design, the Postal Service has recognized other shifts in the distribution of volume. For example, Mr. Moeller's revenue projections recognize the fact that the residual shape surcharge

⁶² See PRC Notice of Inquiry No. 2 Concerning Base Year Data, Attachment 1.

⁶³ See PRC Notice of Inquiry No. 2 Concerning Base Year Data, Attachment 1.

1 imposed in Docket No. R97-1 will result in a reduced volume of residual shape
2 surcharge mail in the test year (as the imposition of the surcharge is not reflected in the
3 residual shape volumes based on FY 98 billing determinants).⁶⁴ Likewise, Dr. Tolley
4 estimates disaggregated volume changes for seven separate rate categories for ECR.
5 Because the rate changes are different and the elasticities are assumed to be the
6 same, the share of total ECR volume will differ for the seven categories when
7 comparing before rates and after rates.

8 Mr. Moeller also assumes that there is no shift in the distribution of volume between
9 piece-rated and pound-rated pieces.⁶⁵ He is also assuming that mailers will not
10 increase the average weight of pieces.⁶⁶ However, he has proposed significant
11 changes in ECR rate design. As the Postal Service and Commission have recognized
12 in the past,⁶⁷ such changes in rate design will cause changes in the composition of
13 traffic, shifting volume away from the categories experiencing rate increases and
14 towards the categories experiencing rate cuts. Thus, changes in the composition of

⁶⁴ Moeller's workpaper 1, pages 13 and 14. Witness Moeller confirms this at Tr. 10/3894-96.

⁶⁵ See Tr. 10/3883: "Similarly with the mix of mail by weight increment, the FY98 data is assumed to be representative of the test year mix, both before *and* after rates." (*italics added*).

⁶⁶ Tr. 10/3883 (Moeller).

⁶⁷ For example, the Commission states in Appendix H of the R97-1 PRC Opinion, page 7:

Where rates vary by weight there exist substitution possibilities among the cells representing different weight categories. Such substitution possibilities become apparent very quickly when the rate schedules

1 traffic across rate cells will occur if rate changes vary disproportionately across cells, as
2 they do here. Witness Moeller even admits this possibility as well, stating: "There may
3 be changes in mail mix due to the proposed rates."⁶⁸ However, he did not fully account
4 for it: "At levels of detail below the volume forecast (e.g., weight per piece, destination
5 entry profile), no quantification of shifts is projected."⁶⁹ Mr. Moeller has no real
6 explanation for not accounting for these shifts other than it made his job easier.⁷⁰

7 However, this difficulty of accounting for migration between rate categories hasn't
8 stopped Dr. Tolley from applying the aggregate subclass elasticity to forecast volumes
9 at the rate category level. Tolley takes the subclass elasticity estimated by witness
10 Thress and applies it to the rate category level, *i.e.*, Automation, Basic letters, Basic
11 nonletters, High-Density letters, High-Density nonletters, Saturation letters, and
12 Saturation nonletters.⁷¹

13 Dr. Tolley's use of the aggregate subclass elasticity to volumes at the rate category
14 level, combined with Mr. Moeller's assumption that test year billing determinants will be
15 the same as FY1998, results in perverse upward-sloping demand curves for some rate

create 'crossovers' as they have occasionally done between
substitutable postal services in the past."

⁶⁸ Tr. 10/3884 (Moeller).

⁶⁹ Tr. 10/3884 (Moeller).

⁷⁰ He states that "The percentage change without controlling for migration is easy to calculate." Tr. 10/3897-98.

⁷¹ It is rarely ever correct to do so. See for example, William B. Tye and Bernard J. Reddy, "Deregulation of freight rates and aggregation error in demand forecasting", ICC Practitioners Journal, September-October 1981.

groups. Basic economic principles state that as prices (rates) increase, quantity (volume) should decrease. This is not always the case in Postal Service predictions. As the following table indicates, some categories (*i.e.*, piece-rated nonletters in the High Density category) are forecasted to experience an increase in rates simultaneously with an increase in volume, while other categories (*i.e.*, pound-rated nonletters in the Saturation category) are forecasted to experience a decrease in rates and a decrease in volume.

Enhanced Carrier Route Subclass

		Volume Forecast		Percent	Revenue/piece		Percent
		BR	AR	Change	BR	AR	Change
		[1]	[2]	[3]	[4]	[5]	[6]
1	Letters						
2	Basic	5665.732	5449.490	-3.82%	0.1477	0.1599	8.28%
3	Auto	1891.225	1851.903	-2.08%	0.1429	0.1492	4.39%
4	High-D	411.860	393.108	-4.55%	0.1199	0.1319	9.99%
5	Saturation	2830.582	2692.107	-4.89%	0.1108	0.1228	10.79%
6	Non-letters-Piece rated						
7	Basic	6636.358	6491.447	-2.18%	0.1441	0.1561	8.37%
8	High-D	6436.887	6340.858	-1.49%	0.1173	0.1237	5.54%
9	Saturation	6436.887	6340.858	-1.49%	0.1173	0.1237	5.54%
10	Non-letters-Pound rated						
11	Basic	5421.791	5303.401	-2.18%	0.2069	0.2096	1.29%
12	High-D	586.101	591.144	0.86%	0.2021	0.1924	-4.82%
13	Saturation	2830.582	2692.107	-4.89%	0.1108	0.1228	10.79%
14	Total ECR	33630.517	32828.211	-2.39%	0.1492	0.1566	4.94%
15	subtotal - letters	10799.400	10386.608	-3.82%	0.1361	0.1472	8.16%
16	subtotal - pc. rated	24753.181	24107.028	-2.61%	0.1331	0.1429	7.38%
17	subtotal - lb. rated NL	8877.336	8721.183	-1.76%	0.1942	0.1947	0.27%
18	subtotal - pc. rated NL	13953.781	13720.420	-1.67%	0.1308	0.1396	6.76%

Sources:

[1]: Moeller WP 1, page 4
 [2]: Moeller WP 1, page 21
 [3]: [2] / [1] - 1

[4], [5]: Moeller WP 1, page 34
 [6]: [5] / [4] - 1

Such results indicate that the volume forecasting model is not fully compatible with the rate proposal. The distribution of after-rates volumes across rate categories estimated

1 by Mr. Moeller must not be correct. The difficulty of accounting for shifts in the
2 composition of traffic further reiterates the undesirability of making changes in rate
3 design unless clearly justified.

4 Clearly, the Postal Service has made no explicit effort to correct its estimates of after-
5 rates revenue/piece to account for shifts in the distribution of volume. Indeed, its
6 forecasts assume perverse and counter-intuitive shifts as a result of overlaying Mr.
7 Moeller's use of FY1998 billing determinants onto Dr. Tolley's partly disaggregated
8 volume forecast.

9 It is difficult to estimate the magnitude of the error, but its direction is clear. Witness
10 Moeller's method of using "before rates" billing determinants to calculate the percentage
11 rate increase is to *overestimate* the actual percentage rate increase in rates that will be
12 realized by the rate proposals, as it does not account for the shift in volumes in
13 response to relative price changes. This is an example of a well-known problem in
14 index numbers.⁷²

15 **F. Under The Postal Service's Proposals, The Unit Contribution Of**
16 **ECR Would Continue To Be Much Less Than That Of First Class**
17 **Mail**

18 The ECR subclass under the Postal Service's proposal continues to contribute much
19 less to institutional costs on a per piece basis compared to First Class. The table below
20 shows that the unit contribution for ECR *is less than half* that of either of the First Class

letters subclasses. The Postal Service has failed to admit the wide disparity in unit contributions, and ducked the issue by noting only that “[r]ate levels have traditionally been discussed in terms of markups or costs coverages, rather than in terms of unit contribution.”⁷³ When asked to explain why the ratio of revenue to volume-variable cost provides the only needed measure, Mayes confirms that unit contributions were not used.⁷⁴

Comparison of Unit Contributions

	ECR	First Class
Using USPS Cost Methodology		
TY After-Rates Unit Revenues	0.1572	0.3622
TY After-Rates Unit Costs	0.0753	0.1837
TY After-Rates Unit Contribution	0.0819	0.1785
Using PRC Cost Methodology		
TY After-Rates Unit Revenues	0.1572	0.3622
TY After-Rates Unit Costs	0.0803	0.2022
TY After-Rates Unit Contribution	0.0769	0.1599

Sources:

Tolley, USPS-LR-I-121

Bernstein, USPS-LR-I-149

Mayes Exhibit USPS-32B [Revised 4-21-00]

I note that the Postal Service proposal also increases the gap between the unit contributions of ECR and First Class mail. The ECR unit contribution (using Commission methodology) would rise by only 0.14 cents, but First Class unit

⁷² For example, see Hal Varian, *Microeconomic Analysis, Second Edition*, page 166, where problem 3.29 calls for the reader to show that the true cost of living index is less than the Laspeyres (“before rates”) price index.

⁷³ Tr. 11/4296 (Mayes). She further confirms that she “did not use unit contributions ‘for the purpose of measuring the relative contributions of the various classes and subclasses.’” Tr. 11/4210 (Mayes).

⁷⁴ Tr. 11/4297 (Mayes).

1 contribution would rise by 1.32 cents.⁷⁵

2 It is important to consider unit contributions. First, they highlight the actual contribution
3 being made by the average piece. This can facilitate comparisons among similar
4 subclasses. Second, unlike cost coverage percentages, unit contributions are not
5 distorted by the differing degrees of worksharing among the various subclasses.

6 **IV. THE POSTAL SERVICE PROPOSAL WILL CONTINUE TO DIVERT MAIL FROM**
7 **PRIVATE ENTERPRISE COMPETITORS**

8 In Docket No. R97-1, the Postal Service explicitly defended its proposed pound rate
9 reduction on a desire to divert mail volume from private enterprise competitors.⁷⁶ The
10 Commission found that: "The evidence suggests that the Postal Service has targeted
11 the ECR subclass for special consideration for competitive reasons."⁷⁷

12 In contrast, in the current rate case the Postal Service denies that a desire to divert
13 volume from private enterprise motivates its current proposals.⁷⁸ The record provides
14 ample reason, however, for concluding that the Postal Service is again inappropriately

⁷⁵ Compare above table with PRC R97-1 Opinion, Appendix G, Schedule 1.

⁷⁶ For example, Mr. Moeller in Docket No. R97-1 stated: "Finally, the Enhanced Carrier Route subclass is in a competitive market and is susceptible to diversion to alternative media. As such, the rate structure should be sensitive to, and priced competitively with, the alternatives. A lower pound rate is more consistent with the rates for other advertising media that are not as sensitive to weight." See Moeller Testimony in Docket R97-1 (USPS-T-36) at 26.

⁷⁷ PRC R97-1 Opinion at 403.

⁷⁸ See for example Tr. 10/3881 (Moeller): "Although the Postal Service understands that there is competition for the type of advertising mailed in the ECR subclass, the pound rate proposal is not based on an effort to stem diversion to alternative

1 targeting private competitors by lowering the cost coverage for ECR mail as well as the
2 pound rate.

3 **A. Reducing The Pound Rate Will Increase Diversion Of Mail**
4 **From Private Sector, Which Witnesses Mayes And Moeller**
5 **Ignore**

6 Witness Moeller states "Despite the reduction in the pound rate, the percentage price
7 change for pound-rated pieces is positive." This statement is seriously misleading, as it
8 does not display how many weight categories of ECR mail will experience a net
9 decrease in rates. The proposed decrease in the pound rate to 58.4 cents will result in
10 drops in rates for many of the heavier-weight ECR categories. In fact, some ECR
11 pound-rated mail is proposed to have their rates decreased by as much as 12.2% (as in
12 the case of 16 ounce high density DDU pieces). See the table below.

media." Also, at Tr. 10/3882, he states: "The lower pound rate is not intended to divert business from other entities involved in the delivery of advertising."

Standard Mail (A) - Enhanced Carrier Route

Proposed Rates (\$)

Overall 4.9%

Pound-rated pieces														
Dest. Entry	cur- rent	pro- posed	%chg at (oz.)											
			4	5	6	7	8	9	10	11	12	13	14	15
Basic														
per piece	0.025	0.055												
per pound	0.663	0.584												
	less	less												
None	0.000	0.000	5.4%	2.3%	0.1%	-1.4%	-2.7%	-3.6%	-4.4%	-5.1%	-5.6%	-6.1%	-6.5%	-6.8%
DBMC	0.079	0.083	5.4%	2.0%	-0.5%	-2.3%	-3.6%	-4.7%	-5.6%	-6.3%	-7.0%	-7.5%	-8.0%	-8.4%
DSCF	0.100	0.108	5.0%	1.4%	-1.1%	-3.0%	-4.4%	-5.5%	-6.5%	-7.2%	-7.9%	-8.4%	-8.9%	-9.3%
DDU	0.126	0.134	5.2%	1.5%	-1.2%	-3.1%	-4.6%	-5.8%	-6.8%	-7.6%	-8.2%	-8.8%	-9.3%	-9.8%
High Density														
per piece	0.014	0.034												
per pound	0.663	0.584												
	less	less												
None	0.000	0.000	0.1%	-2.1%	-3.7%	-4.8%	-5.6%	-6.3%	-6.9%	-7.3%	-7.7%	-8.0%	-8.3%	-8.5%
DBMC	0.079	0.083	-0.5%	-3.0%	-4.8%	-6.1%	-7.0%	-7.8%	-8.4%	-8.9%	-9.3%	-9.7%	-10.0%	-10.3%
DSCF	0.100	0.108	-1.1%	-3.8%	-5.6%	-6.9%	-8.0%	-8.8%	-9.4%	-9.9%	-10.4%	-10.8%	-11.1%	-11.4%
DDU	0.126	0.134	-1.2%	-4.0%	-5.9%	-7.3%	-8.3%	-9.2%	-9.8%	-10.4%	-10.9%	-11.3%	-11.6%	-11.9%
Saturation														
per piece	0.003	0.028												
per pound	0.663	0.584												
	less	less												
None	0.000	0.000	3.1%	0.1%	-1.8%	-3.3%	-4.3%	-5.2%	-5.8%	-6.4%	-6.8%	-7.2%	-7.6%	-7.9%
DBMC	0.079	0.083	2.9%	-0.5%	-2.8%	-4.4%	-5.6%	-6.5%	-7.3%	-7.9%	-8.4%	-8.9%	-9.3%	-9.6%
DSCF	0.100	0.108	2.3%	-1.2%	-3.6%	-5.2%	-6.5%	-7.5%	-8.3%	-8.9%	-9.5%	-9.9%	-10.3%	-10.7%
DDU	0.126	0.134	2.4%	-1.3%	-3.7%	-5.5%	-6.8%	-7.8%	-8.7%	-9.4%	-9.9%	-10.4%	-10.8%	-11.2%

Source: Moeller WP 1, page 31

1

2 In contrast, minimum per piece rates are all proposed to increase.

3 The effect of the Postal Service's proposals here is the same as Docket No. R97-1:

4 Rate decreases are targeted at the heavier pound-rated ECR traffic.⁷⁹ Despite Mr.

5 Moeller's protestations, his proposed reductions in cost coverage for ECR Mail in this

⁷⁹ The Postal Service certainly gives the appearance of identifying with the needs of mailers of ECR pound-rated mail. Witness Moeller states "On November 6, 1998, I attended a meeting with Standard Mail (A) industry representatives from the Saturation Mail Coalition and the Mail Order Association of America during which the pound rate was discussed." Tr. 10/3914.

1 proceeding are nevertheless consistent with the Postal Service's objective of diverting
2 mail from private sector competitors.

3 In fact, the Postal Service shows that it has been highly successful in doing so.

4 Witness Tolley estimates that fully 16.43% of the volume increase in ECR occurs as a
5 result of past decisions to allow the ECR pound rate to decline in real terms, while rates
6 of private enterprise competitors have gone up.⁸⁰ This shows that the Postal Service
7 has been successful at competing, despite any Postal Service denials. It also
8 undercuts any arguments that the Postal Service is being threatened by ECR
9 competitors.

10 The Postal Service's own testimony presents a cross elasticity of ECR mail volume with
11 respect to newspaper advertising prices of 0.812, while their own price elasticity is –
12 0.808. This would indicate that a 1% increase in the price of newspaper advertising
13 would have almost exactly the same effect on Standard A ECR mail volume as a 1%
14 decrease in the price of Standard A ECR mail. Mayes states in her testimony (USPS-T-
15 32) at 39, lines 2-4 "...both alternate delivery firms and newspaper inserts may provide
16 ways of delivering the same advertising message that would be carried in ECR."

17 Witness Tolley's testimony shows that the shift in volume from the private sector to
18 ECR has been significant. The Postal Service's efforts to hold down ECR rates have
19 attracted a huge volume. Ms. Mayes professes to be unable to find any evidence of the

⁸⁰ See Witness Tolley's Testimony USPS-T-6 at page 132, Table 12.

1 effect of Postal Service rates on competitors of ECR, but the evidence may be found in
2 the Postal Service's direct case.

3 Both witnesses Moeller⁸¹ and Mayes⁸² admit they have given no consideration to the
4 impact of the ECR rate proposal on competitors with ECR mail. Effects on competitors
5 cannot be determined simply by comparing "the test year before and test year after
6 rates forecasts of postal volumes for each subclass or rate category for which volumes
7 were forecasted." Tr. 11/4289 (Mayes). As a result, neither Ms. Mayes nor Mr. Moeller
8 has considered the impact of rates on competitors, an explicit requirement previously
9 identified by the Commission in assessing proposed cuts in the pound rate.

10 **B. Absent A Cost Justification, There Is No Justification For**
11 **Different Rate Changes In ECR**

12 In the Postal Service's proposal, some rates are going up in ECR, while others are
13 going down (e.g., the pound-rated pieces examples). However, there is no evidence
14 that there are different levels of competition within different rate cells. Ergo, there is no

⁸¹ Moeller states: "Available alternatives are considered at the subclass level. While this concept may be relevant for rate design, it was not a factor in the proposed Standard Mail (A) rate design discussed in my testimony." Tr. 10/3967-68.

⁸² At the same time Witness Mayes also claims not to have studied the impacts on competitors: "As an example, the Postal Services does not have full information regarding the prices charged by competitors. Some changes to postal rates may cause harm to those competitors, but without knowledge of the cost structure or pricing practices of the competitors, there would not have been opportunity to prevent such harm." Tr. 11/4275 (Mayes). When asked to identify all the factors considered in evaluating the effects on competitors, Mayes was "aware of reports of rate changes for several private companies which provide delivery services, both general rate changes as well as rate surcharges specifically tied to service for particular areas or, in part, to increases in fuel prices" (Tr. 11/4289 (Mayes)), but no apparent consideration was given to any impacts on competitors.

1 reason not to raise the rates for the cells with proposed declines in rates except a cost
2 rationale. However, no valid cost rationale exists for doing so; in particular, there is no
3 cost rationale for pound rates to go down while piece rates rise. Hence, there is no
4 justification for changes in the rate design, and the Commission should recommend
5 common increases in undiscounted ECR rates.

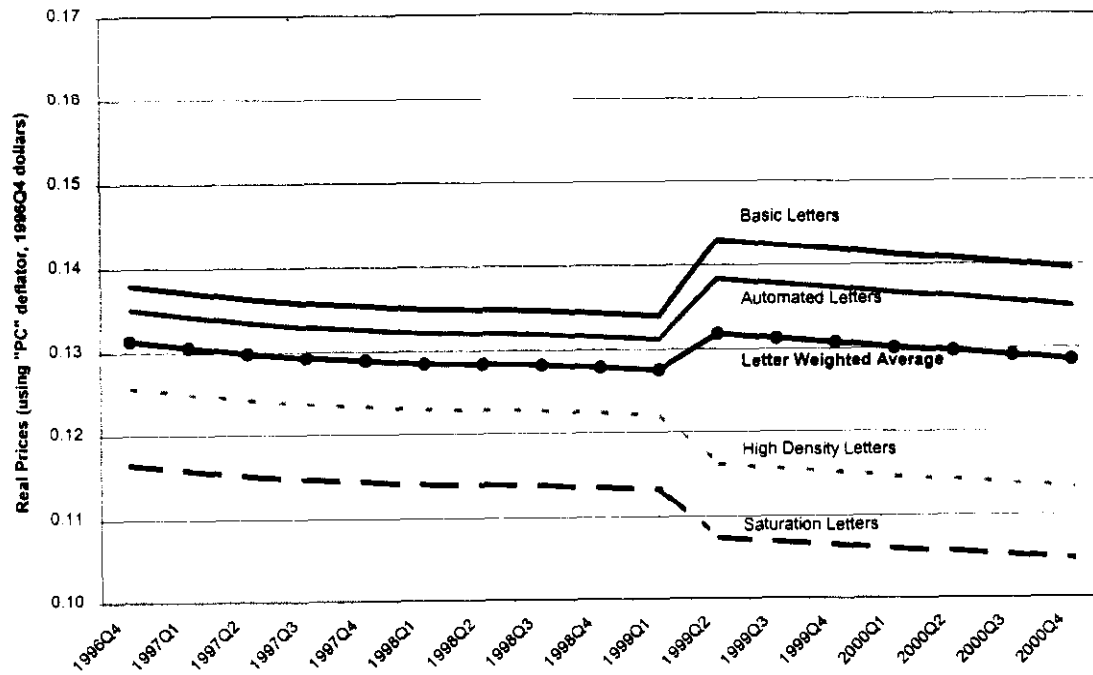
6 In addition, the ECR percent rate change represents a rate decline relative to the other
7 classes of Standard A. Standard Regular rates are forecasted to increase by 9.4%.
8 Nonprofit ECR rates are forecasted to increase by 14.8%. The proposed ECR rate
9 increase is also significantly less than the systemwide rate increase of 6.4%. There is
10 no rational explanation for these discrepancies other than a desire to divert additional
11 mail to ECR from private enterprise competitors.

12 **C. Real Overall ECR Rates And Real Overall Pound Rates Are** 13 **Declining**

14 The current ECR rate proposals are part of a trend, as evidenced by declines in overall
15 ECR rates and in the real pound rate. The following charts⁸³ show that all the nonletter
16 categories have declined in real terms since 1996Q4. The decline in the real pound
17 rate is even more pronounced, indicating that the Postal Service is targeting the heavier
18 pieces for diversion.

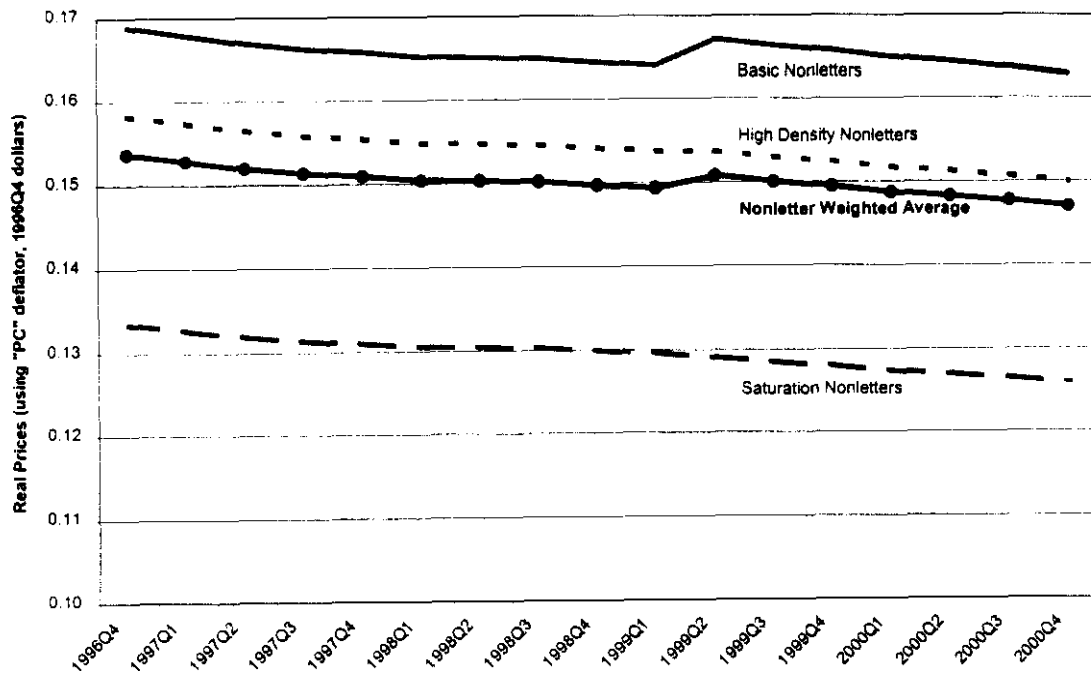
⁸³ The following charts use Dr. Tolley's "PC" deflator, but a deflator such as Mr. Tayman's measure of general inflation would show similar results. Source: Witness Tolley Workpapers, LR-I-121, weighted average constructed using fixed proportions as given by Dr. Tolley's Before-Rates volumes.

Real ECR Letter Prices



1

Real ECR Nonletter Prices

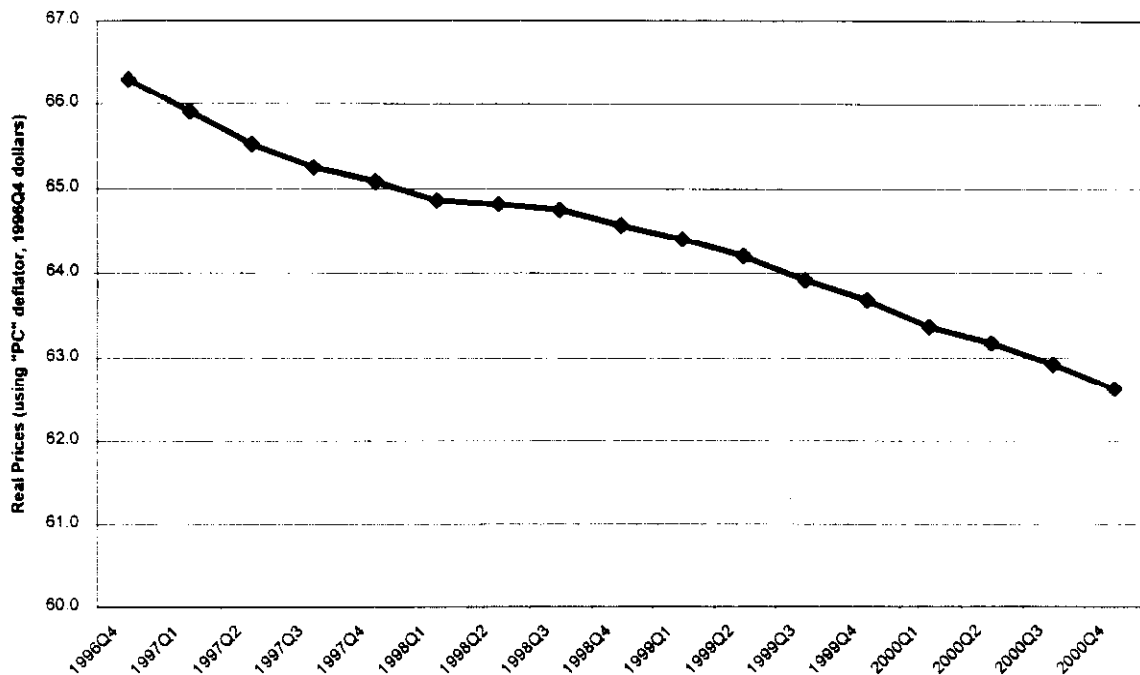


1

2 The real ECR pound-rate has continually decreased since the inception of the ECR
 3 subclass, because the nominal ECR pound-rate has remained fixed at 66.3 cents per
 4 pound.⁸⁴

⁸⁴ See USPS-LR-I-118 for the rate history.

Real Pound Rate



V. DETERMINATION OF MORE APPROPRIATE ECR COST COVERAGE AND RATE PROPOSALS

The appropriate cost coverage and percentage rate increases for ECR should correct the deficiencies in the Postal Service's current proposals. The real issue, then, is what the ratemaking objectives should be: Should they be the Postal Service's stealth objective of diverting mail from private enterprise competitors, or should they rather establish rational relationships among ECR and other subclasses?

To determine the appropriate cost coverages and percentage rate increases for ECR, I first examine the effects of worksharing on cost coverage. I then identify those ratemaking objectives that ought to be considered in determining the appropriate rate increases for ECR.

1 **A. The Commission And The Postal Service Agree That Heavily**
2 **Workshared Subclasses Have High Cost Coverages As A Matter**
3 **Of Mathematics**

4 Relatively high cost coverages for heavily workshared classes are not an anomaly, but
5 rather the direct consequence of basing rate discounts on avoided costs of
6 worksharing. The Commission in Docket No. R97-1 stated "The high coverage
7 assigned Standard A ECR also recognizes that reasonably priced alternatives are
8 available (§3622(b)(5)), and that rates reflect significant worksharing (§3622(b)(6))"⁸⁵
9 Dr. O'Hara in R97-1 agreed with the Commission.⁸⁶ Ms. Mayes also appears to agree
10 with the Commission's sentiments in R97-1.⁸⁷ However, there is no specific
11 consideration of the effect of worksharing on the cost coverage in the Postal Service's
12 current proposals.

⁸⁵ PRC R97-1 Opinion at 447.

⁸⁶ For example, O'Hara Testimony (USPS-T-30) at 9 stated "Similarly, to maintain its contribution, the coverage of a subclass with a greater-than-average increase in worksharing will need to increase relative to the system-average coverage," where the associated footnote says, "It has been suggested that, over time, improved cost analysis should permit an increasing percentage of total costs to be attributed. Working in the opposite direction, however, has been the trend toward increased worksharing, which decreases the percentage of costs that are in fact attributable. It may well be that this latter effect has outweighed the former."

⁸⁷ At Tr. 11/4293, Ms. Mayes states: "A seemingly high cost coverage might have been the result of high levels of worksharing participation which reduced the denominator, rather than a high revenue and institutional cost burden which would have increased the numerator. In particular, this was of concern when determining the cost coverage for First-Class Letters and Cards... and ECR." She reiterates this at Tr. 11/4292 (Mayes).

1 **B. Cost Coverage Goals**

2 ***Goal 1: Making appropriate recognition of rate***
3 ***relationships and crossovers***

4 An appropriate cost coverage and rate structure should appropriately recognize the rate
5 relationships and crossovers with other subclasses. As the Commission recognized in
6 Docket No. R97-1, raising the cost coverage of ECR creates more "headroom" for a
7 desirable rate differential between ECR basic and the 5-digit automation.

8 ***Goal 2: Avoiding unfair competition with private***
9 ***enterprise***

10 Dropping the pound rate and lowering ECR cost coverage would have the effect of
11 diverting volume from private enterprise competitors of ECR mail. Combining an
12 increase in the extra ounce rate for monopoly First Class Mail and a decrease in the
13 pound rate for competitive ECR Mail has the effect of decreasing volume from the first
14 and increasing volume in the latter. An appropriate cost coverage and rate structure for
15 ECR should avoid relying on rate increases on monopoly mail in order to finance (via
16 the markup) rate cuts for mail facing competition.

17 Protecting monopoly customers would require that the Postal Service move toward
18 increasing the contribution from competitive classes such as ECR. Rate increases in
19 competitive subclasses will increase the net contribution to institutional cost and also
20 arrest the past increases in volume of competitive classes due to diversion from private
21 enterprise competitors.

1 **Goal 3: Avoiding unnecessary departures from**
2 **historical rates**

3 An appropriate cost coverage and rate structure should make historical rates the
4 starting point for future rates unless justified by changed circumstances or necessary to
5 correct a historical problem."⁸⁸ Since there has been no substantiated change in
6 circumstances for ECR, the Commission should ensure that the cost coverage or
7 markup index does not decline in either absolute or relative terms.

8 **Goal 4: Recognize that cost coverages are affected by**
9 **other ratemaking goals such as worksharing**

10 The ECR cost coverage is largely the result of other ratemaking goals such as providing
11 appropriate incentives for the high degree of worksharing, maintaining rational
12 relationships among ECR and other subclasses, and the extensive use by ECR of
13 postal functions (such as delivery) which are the major sources of institutional costs.

14 **C. Rate Proposals**

15 For the reasons I have discussed above, the Postal Service has failed to justify its
16 proposal to reduce either the ECR pound rate or the ECR cost coverage. There is no
17 data to support reducing the pound rate, nor has the Postal Service offered any
18 justification for lowering the cost coverage or changing the rate design within ECR.
19 Accordingly, I recommend that the Commission adjust the existing set of ECR rates to
20 the Test Year (incorporating 1999 actual costs in the process) so that:

⁸⁸ The Commission stated in R97-1 that it "relies on the precedential value of its past evaluations of the evidence as a starting point and then evaluates new evidence

- 1 ■ The real contribution per piece, after adjusting for attributable costs using the
2 Commission's approved methodology, equals or exceeds the unit contribution
3 of commercial ECR mail at R97-1 levels and that the cost coverage or
4 markup indices do not decline in absolute or relative terms; and
- 5 ■ Undiscounted piece-rated and pound-rated ECR mail receive common rate
6 increases.

7 While I have not calculated Test Year attributable costs using the Commission's
8 methodology in light of the actual 1999 data,⁸⁹ it would appear that setting rates
9 pursuant to these principles would achieve the goals that I have identified.

presented to determine whether changes from its past allocation decisions are appropriate." PRC R97-1 Opinion at 229.

⁸⁹ The Postal Service provided a calculation of Test Year attributable costs using the Commission's methodology in LR-I-131. This has not been updated since the filing to reflect either the actual 1999 CRA data or various errata to date.

APPENDIX A: Curriculum Vitae

Dr. William B. Tye received his B.A. in economics from Emory University and his Ph.D. in economics from Harvard University. Upon leaving Harvard, he became assistant professor of economics and management at the U.S. Air Force Academy, holding the rank of Captain. There he taught quantitative economic theory, econometrics, policy issues in contemporary economics and quantitative decision methods. After leaving the service in 1972, he joined Charles River Associates, a Boston research and consulting firm, as a senior research associate and was promoted to program manager for transportation, and later to vice president and a director of the company. He joined Putnam, Hayes & Bartlett, Inc. in 1980 as a Principal. In August 1990 Dr. Tye and six colleagues founded *The Brattle Group*. *The Brattle Group* is the successor firm resulting from the merger of The Brattle Group, Inc. and Incentives Research, Inc., and was known for a year as Brattle/IRI.

RECENT ASSIGNMENTS

Dr. Tye, an expert in economic analysis and public policy, has been an economic consultant for over twenty years. He specializes in regulatory and antitrust issues. His clients have included regulatory bodies, firms in regulated industries and law firms. He has authored or co-authored over one hundred papers and publications, including four books. Some recent consulting assignments include:

- **Antitrust Analysis:** performed studies of competition in silicon, railroading, international telecommunications, petroleum, electric utilities, and natural gas pipelines.

- **Estimating Damages:** provided economic analysis of damages in a case involving claims of alleged fraud in franchising and damage claims from alleged overcharges in the retailing of gasoline.

- **Settlement Values and Strategies:** used business decision and planning tools successfully in consultation with attorneys to develop optimal litigation/settlement strategies in several recent cases.

- **Regulatory Economics:** testified on mergers between regulated firms, on the economic aspects of automobile franchise regulation in a case between a dealer and an automobile manufacturer, on cost allocation issues involving different petroleum streams on the Trans Alaska Pipeline (TAPS), and on the cost of capital and proper calculation of avoided costs in the electric utility industry.

Management: provided assistance to senior management of a large utility seeking a successful transition to a more competitive business environment.

PAPERS AND PUBLICATIONS

"The Economic Costs of the Urban Mass Transportation Capital Grant Program," Ph.D. dissertation, Harvard University, 1969.

"The Capital Grant as a Subsidy Device: The Case Study of Urban Mass Transit," Prepared for the U.S. Congress, Joint Economic Committee, Subcommittee on Priorities and Economy in Government. Published in *The Economics of Federal Subsidy Programs: Part 6—Transportation Subsidies*. Washington, DC: Government Printing Office, 1973.

"The Application of Behavioral Travel Demand Models," In *Behavioral Travel-Demand Models*, edited by Peter R. Stopher and Arnim H. Meyberg. Lexington, MA: Lexington Books, 1975.

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"Research Issues in the Costs of Urban Goods Pickup and Delivery," in *Goods Transportation in Urban Areas—GTUA III*, edited by Gordon P. Fisher, *Proceedings of the Third Engineering Foundation Conference*, Sea Island, GA, 4-9 December 1977 (Springfield, VA: National Technical Information Service, June 1978).

"Consumer Segmentation," in *Behavioral Travel Modelling*, edited by D. A. Hensher and P. R. Stopher, *Proceedings of The Third International Conference on Behavioral Travel Modelling 1977*, Tanunda, South Australia (London: Croom Helm, 1979).

"State-Owned Enterprises and Predatory Competition in International Markets: International Airlines as a Case Study," with John R. Meyer, presented at the Conference on State-Owned Enterprises, Harvard Business School, 26-28 March 1979.

"Multinomial Probit: The Theory and Its Application to Demand Forecasting, by Carlos Daganzo," book review, *Transportation* (October 1980): 301-302.

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"Review of Analytical Models of Gasoline Demand During an Energy Emergency," presented at the National Energy Users Conference on Contingency Planning: Transportation, San Antonio, TX, April 1980. Published in *Transportation Research Record No. 764: Transportation Energy: Data, Forecasting, Policy, and Models* (Washington, DC: Transportation Research Board, 1981).

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"Valuation Methodologies for Public Takeovers of Regulated Rail Assets," *Transportation Practitioners Journal*, Vol. 57, No. 4 (Summer 1990): 364-384.

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"Optimal Time Structures for Rates in Regulated Industries," with A. Lawrence Kolbe, *Transportation Practitioners Journal*, Vol. 59, No. 2 (Winter 1992): 176-196. Published in *Public Utilities Law Anthology*, Vol. XV (July-December 1992).

"Practical Implications of the Supreme Court's *Duquesne* Opinion for Regulated Industries," with A. Lawrence Kolbe, *Public Utilities Fortnightly*, August 30, 1990.

"The Fair Allowed Rate of Return with Regulatory Risk," with A. Lawrence Kolbe, *Research in Law and Economics*, Vol. 15 (1992): 129-169.

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"The Not-So-Strange Economics of Stranded Investment" (A Reply) with Johannes P. Pfeifenberger, *The Electricity Journal* (November 1994): 3, 80.

"How to Value a Lost Opportunity," with Stephen H. Kalos and A. Lawrence Kolbe, Section of Antitrust Law, American Bar Association, 1991 Annual Meeting, Atlanta, Georgia, *Defining, Proving, and Measuring Antitrust Damages*, August 13, 1991. *Research in Law and Economics*, Vol. 17 (1995): 83-125.

"It Ain't In There: The Cost of Capital Does Not Automatically Compensate for Stranded Cost" with A. Lawrence Kolbe, *Public Utilities Fortnightly*, Vol. 133, No. 10 (May 15, 1995): 26-28.

"Handle with Care: A Primer on Incentive Regulation" with Johannes P. Pfeifenberger, *Energy Policy*, Vol. 23, No. 9 (September 1995): 769-779.

"The Economics of Pricing Network Interconnection: Theory and Application to the Market for Telecommunications in New Zealand" with Carlos Lapuerta, *The Yale Journal on Regulation*, Vol. 13, No. 2 (Summer, 1996): 419-500.

"Antitrust Damages from Lost Opportunities," with Stephen H. Kalos, *The Antitrust Bulletin* (Fall 1996): 637-664.

"Response to Book Review," with A. Lawrence Kolbe and Stewart C. Myers, *The Yale Journal on Regulation*, Vol. 13, No. 1 (Winter 1996): 413-417.

"Stranded Cost Recovery and Competition on Equal Terms," with Frank C. Graves, *The Electricity Journal*, Vol. 9, No. 10 (December 1996): 61-70.

"Compensation for the Risk of Stranded Costs," with A. Lawrence Kolbe, *Energy Policy*, Vol. 24, No. 12 (1996): 1025-1050.

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"The Economics of Negative Barriers to Entry: How to Recover Stranded Costs and Achieve Competition on Equal Terms in the Electric Utility Industry," with Frank C. Graves, University of New Mexico School of Law *Natural Resources Journal*, Vol. 37, No. 1 (Winter 1997): 175-250.

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"Guide to Economic Damages," in *Expert Evidence: A Practitioner's Guide to Law, Science and the FJC Manual*, Bert Black and Patrick W. Lee, eds., (St. Paul, MN: West Publishing Company, 1997).

"Achieving Competitive Neutrality in Rail Competitive Access Disputes," *Journal of Transportation Law, Logistics, and Policy*, Vol. 65, No. 4 (Summer 1998): 343-358

"Promoting Effective Competition Through Interconnection Policy," with Carlos Lapuerta, *Telecommunications Policy*, Vol. 23 (March 1999): 129-145.

TESTIMONY

Assisted in preparation of expert testimony before the Postal Rate Commission in 1974 and 1976.

Assisted Professor Franklin Fisher in preparation of expert testimony in antitrust litigation (CBS v. ASCAP).

Testimony before the Postal Rate Commission on behalf of United Parcel Service, Docket No. R77-1, filed 14 October 1977.

Direct testimony before the Postal Rate Commission on behalf of United Parcel Service, Docket No. MC78-1, filed 4 April 1979, and supplemental testimony, filed 15 June 1979.

Assisted Professor Stewart C. Myers in the preparation of expert testimony on rate base methodology and rate of return in the oil pipeline industry before the Federal Energy Regulatory Commission, Docket No. OR79-1.

Assisted in the preparation of expert testimony on the subject of profit renegotiation for a government contractor performing trucking services, 1979.

Testimony before the Civil Aeronautics Board on behalf of Eastern Airlines, Miami-London Route Case, Docket No. 36764, 13 December 1979.

Testimony before the Civil Aeronautics Board on behalf of Eastern Airlines, Florida-Mexico City Route Investigation, Docket No. 32820, 16 July 1980.

Testimony before the Postal Rate Commission on behalf of United Parcel Service, Docket No. R80-1, filed 13 August 1980.

Testimony before the Motor Carrier Ratemaking Study Commission on behalf of Motor Common Carrier Associations, 19 March 1982.

Testimony before the ICC on behalf of the National Coal Association, *Coal Rate Guidelines—Nationwide, Ex Parte* No. 347 (Sub-No. 1), 13 April 1982.

Testimony before the ICC on behalf of The Dayton Power and Light Company (v. Louisville and Nashville Railroad Company), Docket No. 38025, 6 April 1982 (direct) and 7 June 1982 (rebuttal).

Statement prepared for the Motor Carrier Ratemaking Study Commission, "Review of Regulatory Reform and the Trucking Industry: An Evaluation of the Motor Carrier Act of 1980," May 1982.

Testimony before the ICC on behalf of Niagara Mohawk Power Corporation (v. Conrail *et al.*), Docket No. 38336S, 21 July 1982.

Testimony before the ICC on behalf of Commonwealth Edison *et al.* (v. Aberdeen and Rockfish Railroad Company *et al.*), Docket No. 37891 *et al.*, 9 August 1982, 25 October 1982, and 14 February 1983.

Testimony before the ICC on behalf of Consumers Power Company, Docket No. 37854S *et al.*, 6 October 1982, 28 December 1982, and 1 August 1983; in Docket No. 38181S, 15 October 1982, 31 December 1982, and 2 August 1983; in Docket No. 37853S *et al.*, on 12 November 1982, 13 January 1983, and 29 August 1983; and in Docket No. 37857S *et al.*, on 24 January 1983, 25 March 1983, and 10 January 1985.

Statement prepared for the Motor Carrier Ratemaking Study Commission, "The Motor Carrier Market Place Without Collective Ratemaking," 24 November 1982.

Testimony before the ICC on behalf of Delmarva Power and Light Company, Docket Nos. 38329 and 38330, 31 January 1983.

Testimony before the ICC on behalf of Mobil Chemical Company, Docket No. 37850S, 30 March 1983, and 31 May 1983.

Testimony on behalf of Kansas Gas and Electric Company in Civil Action No. 83-1104, United States District Court for the District of Kansas, 19 April 1983.

Testimony before the ICC on behalf of Consumers Power Company, *Ex Parte* No. 347 (Sub-No. 1), "Coal Rate Guidelines—Nationwide," 28 July 1983.

Testimony before the ICC on behalf of Detroit Edison Company, Docket Nos. 38279S *et al.*, 22 December 1983, 13 February 1984, 14 March 1984, and 5 April 1984.

Testimony before the ICC on behalf of National Coal Association, 14 February 1984, in Finance Docket No. 30300, CSX Corporation—Control—American Commercial Lines, Inc.

Testimony on behalf of MKT Railroad before the ICC, 10 September 1984, 21 November 1984, and 29 May 1985, in Finance Docket No. 30,400 *et al.*, SFSP Merger Proceedings.

Testimony before the ICC, 31 May 1985 and 8 July 1985, *Ex Parte* No. 445 (Sub-No. 1), *Intramodal Rail Competition*.

Testimony on behalf of Presidential Airlines in Docket No. 43825, *Texas Air—Eastern Acquisition Case*, before the Department of Transportation, 13 May 1986.

Panelist in a two-day colloquium on rail costing issues, 18-19 June 1986, before the Railroad Accounting Principles Board.

Deposition in *Farmers Electric Cooperative vs. Arkansas Power and Light Company*, U.S. District Court for the Eastern District of Arkansas, 27 June 1986.

Affidavit before an arbitration panel in the matter of Marilyn Benjamin, Administrator and Traffic Executive Association, Eastern Railroads, 29 May 1986.

Testimony on behalf of Presidential Airlines in Docket No. 44365, *Joint Application of Texas Air Corporation and People Express, Inc.*, merger proceeding before the Department of Transportation, 21 October 1986.

Deposition in *City of Austin et al. v. Decker Coal Company et al.*, No. A-85-CA-104, U.S. District Court, Western District of Texas, 2 April 1987.

Testimony before the ICC on behalf of the Commonwealth of Massachusetts in Docket Nos. 31250 and 31259, *Conveyance of B&M Corporation Interests in Conn River Line*, 13 June 1988 and Reply Testimony on 13 July 1988.

Testimony before the Illinois Commerce Commission on behalf of Mississippi River Transmission in *Application of Illini Carrier*, 13 May 1988.

Testimony before the ICC on behalf of the Commonwealth of Massachusetts in *Ex Parte* No. 274 (Sub-No. 11A), *Abandonment Regulations—Costing*, 8 July 1988.

Deposition in *James River Corporation vs. Northwest Pipeline Corporation*, 13-15 March, 12-14 April 1989.

Testimony before the Missouri Public Service Commission, Application of Missouri Pipeline Company, 10 May 1989 and 30 May 1989.

Testimony before the Public Utilities Commission of California, Application No. 88-07-020 *et al.*, 5 January 1990, on behalf of US Sprint.

Testimony before the ICC on behalf of Rio Grande Industries, Inc., *Finance Docket No. 31505, Rio Grande Industries, Inc. et al.—Purchase and Related Trackage Rights—Soo Line Railroad Company Line Between Kansas City, MO and Chicago, IL*, 15 February 1990.

Expert's Report and Deposition, in *Litton Industries et al. v. Chesapeake and Ohio Railway Co. et al.*, Northern District of Ohio, Eastern Division, 11 April 1990.

Testimony before the Michigan Public Service Commission, Application of TNT Holland Motor Express, Inc. for Extension of Operations, 20 July 1990.

Carolina Power & Light Company, Project No. 432, before the Federal Energy Regulatory Commission, 15 March 1991.

Expert's Report and Deposition, *NCEMC v. Carolina Power and Light Company*, 11 March 1992.

Testimony before the Federal Energy Regulatory Commission, on behalf of Amerada Hess Pipeline Corporation, 30 March 1992 and Rebuttal Testimony, 10 August 1992.

Deposition in *Richard Lundgren, Inc. v. American Honda Motor Co., Inc.*, Civil Action No. 92-1091, Commonwealth of Massachusetts, February 5, 1983, and Testimony before the Superior Court of Massachusetts, Worcester, Massachusetts, 27 September 1994.

Deposition in *Empresas Puertorriquenas de Desarrollo, Inc. v. F.W. Woolworth Co.*, United States District Court for the District of Puerto Rico, 4 March 1993.

Testimony before the Interstate Commerce Commission, *Seaboard Air Line Railroad Company—Merger—Atlantic Coast Line Railroad Company: Petition to Remove Traffic Conditions*, Finance Docket No. 21215 (Sub-No.5), 29 March 1993.

Testimony before the Postal Rate Commission, *Bulk Small Parcel Service*, Docket No. MC93-1, 16 April 1993.

Testimony before the Commonwealth of Massachusetts Department of Public Utilities, DPU 93-167, *For the Purpose of Establishing Guidelines and Standards for Acquisitions and Mergers Of Utilities*, 16 February 1994.

Deposition, *Texaco Puerto Rico, Inc., et al., v. Department of Consumer Affairs*, United States District Court for the District of Puerto Rico, 21 April 1994, Expert's Report and Testimony before the Court, 2 August 1994.

"Competition in the Market for Trans-Oceanic Facilities-Based Telecommunications Services," with Hendrik S. Houthakker and Johannes P. Pfeifenberger, before the Federal Communications Commission, June 24, 1994 (also related studies filed October 25, 1996; April 23, 1997 and July 7, 1997).

Prepared Testimony before the Public Utilities Commission of the State of Hawaii, on behalf of Citizens Utilities Company, Kauai Electric Division, 21 July 1994, and oral testimony, 1 May 1995.

Prepared Rebuttal Testimony on behalf of Hawaiian Electric Light Company (Subject: Risks of Purchased Power Contracts), before the Public Utilities Commission of the State of Hawaii, December 1994.

Reply Testimony (with A. Lawrence Kolbe) on Behalf of Edison Electric Institute, Docket No. RM94-7-000, before the Federal Energy Regulatory Commission, 23 January 1995.

"The Economics of Pricing Network Access in the Market for Telecommunications in New Zealand" (with Carlos Lapuerta), prepared for the Minister of Commerce and the Minister of Communications on behalf of Clear Communications, Ltd, 17 February 1995.

Prepared Direct Testimony on behalf of the Designated TAPS Carriers, before the Federal Energy Regulatory Commission and Alaska Public Utilities Commission, Docket Nos. IS94-10-002, *et al.* (Phase II), 14 March 1995.

"Damages from Delay of Essex Government Contract," Expert's Report in *Essex Corp. v. Wackenhut Services, Inc.*, in the United States District Court for the District of New Mexico, March 23, 1995, Deposition, April 25, 1995, and Supplemental Report, January 11, 1996.

Testimony before the I.C.C., Finance Docket No. 32549, *Burlington Northern, Inc. and Burlington Northern Railroad Company—Control and Merger—Santa Fe Pacific Corporation and Atchison, Topeka and Santa Fe Railway Company*, May 10, 1995.

Testimony before the U.S. District Court, Southern District of New York, *New York Urban League v. Metropolitan Transportation Authority*, November 2, 1995.

"Post Merger 'Character of Rivalry' in the Proposed 'SOP/UP' Railroad Merger," before the Texas Railroad Commission, February 5, 1996.

Testimony before the Surface Transportation Board, Docket No. 32760, *Union Pacific—Southern Pacific* merger proceeding, March 29, 1996.

Rebuttal Testimony before the Rhode Island Public Utility Commission, "Stranded Cost Recovery," Docket No. 2320, *Electric Utility Restructuring*, July 23, 1996.

Testimony before the New Hampshire Public Utilities Commission, Docket No. DE 96-252, AT&T Communications of New Hampshire, Inc., *Petition for Arbitration with NYNEX*, October 7, 1996.

Testimony before the Massachusetts Department of Public Utilities, AT&T/NYNEX Arbitration, Docket No. DPU 96-80181, October 22, 1996.

Testimony before the Federal Communications Commissions, "Economic Implications of the Proposed Hughes - PanAmSat Transactions" (with Johannes P. Pfeifenger), December 2, 1996.

"Analysis of Cure Costs for Contract Breach Damages Suffered by Homell Brewing Company, Inc. from Beverage Enterprises" (with M. Alexis Maniatis), September 1997.

Expert Report, January 9, 1998, In Re Industrial Silicon Antitrust Litigation, U.S. District Court for the Western District of Pennsylvania. Deposition, February 12-13, 1998; affidavits, April 13, 1998 and July 28, 1998; and testimony, September 8, 1998, and November 4, 1998.

Expert Report of William B. Tye, February 17, 1998, *PTP Industries, Inc. v. America Online, Inc.*, U.S. District Court for the District of Maryland and deposition, April 1, 1998.

Expert Report (with Johannes P. Pfeifenger), *COMSAT Corporation v. The News Corporation, et al.*, United States District Court, Central District of California, July 1, 1998.

Expert Report, *U.S. Airways v. British Airways*, United States District Court, Southern District of New York, November 6, 1998, and deposition, December 14, 1998.

Prepared Direct Testimony, Before The Alaska Public Utilities Commission, October 8, 1998.

SPECIAL CONSULTING ASSIGNMENTS

The Joint Economic Committee, U.S. Congress, working on a project entitled "The Capital Grant as a Subsidy Device: The Case of Urban Mass Transportation." The report on this study was published in 1973.

The Office of the Assistant Secretary for Policy and International Affairs, U.S. Department of Transportation, on the subject of subsidy mechanisms for urban mass transportation. He participated in the drafting of a report to the Congress on the subject.

The Assistant Secretary for Metropolitan Development, U.S. Department of Housing and Urban Development. The work involved experimental design for urban mass transportation demonstrations and an evaluation of the impact of the urban mass transportation capital grant program in nine U.S. cities.

The U.S. Department of Transportation study entitled "Transportation Needs of the Handicapped."

PROFESSIONAL ACTIVITIES

Chairman of a Conference on the Economic Regulation of Urban Transportation in September 1976, sponsored by the Transportation Research Board.

Workshop chairman on market segmentation at the Third International Conference on Behavioral Travel Modelling 1977 in Australia.

Discussion leader at a conference of 150 practitioners of transportation demand analysis sponsored by the U.S. Department of Transportation (Seminar on Emerging Transportation Planning Methods, Daytona Beach, Florida, December 1976). The subject of this session was "Manual Forecasting and Sketch Planning Methods."

Chairman of the workshop on "The Application of Behavioral Travel Demand Models," Second International Conference on Behavioral Travel Demand.

Former Member, Committee on Taxation, Finance and Pricing of the Transportation Research Board.

Attendant at the Fourth International Conference on Behavioral Travel Modelling held in Eibsee, Germany, July 1979.

Former Member, Committee on Pipeline Transportation, of the National Research Council (National Academy of Sciences), Transportation Research Board.

Member, American Economics Association, Econometric Society, Transportation Research Forum, American Bar Association (Associate).

Referee for the *Quarterly Journal of Economics*, the *Journal of Regional Science*, *Transportation Research*, *Transportation*, the *Journal of Industrial Economics*, the *Journal of Policy Analysis & Management*, the *Rand Journal of Economics*, and the *Journal of Law and Economics*.

National President, 1983; Executive Vice President, 1982; and Programs Vice President, 1981; Transportation Research Forum.

Former Member, Editorial Board, *Transportation Antitrust Report*.

Former Member, Editorial Review Board, *Logistics and Transportation Review*.

Former Council Member, Harvard Graduate Society for Study and Research (Harvard Graduate School of Arts and Sciences).

Former Member, Committee on Surface Freight Transportation Regulation, Transportation Research Board, National Research Council.

Workshop Chair, "Understanding Competition and Antitrust Behavior," The Second International Conference on Privatization and Deregulation in Passenger Demand, Tampere, Finland, June 1991.

Advisory Committee, *Yale Journal on Regulation*.

Faculty Member, Advanced Regulatory Studies Program, National Association of Regulatory Utility Commissioners, February 16-21, 1992.

Former Member, Dean's Council, Emory College.

PUBLIC SPEAKING

"Problems Confronting Regulated Industries in a Period of Runaway Inflation," presented to Delta Nu Alpha, transportation fraternity in Boston, Massachusetts, 1975.

"Urban Transportation: Alternatives for Public Policy," presented to Traffic Clubs International in Denver, Colorado, 1971.

"Current Financial Issues in Regulation of Freight Transportation," presented at the Seminar on Freight Policy Analysis at the U.S. Department of Transportation, Transportation Systems Center, 3 April 1980.

"Transportation and Related Industries in the U.S. Economy" (with John R. Meyer), presented at the Transportation Economic Seminar to the senior staff of the U.S. Department of Transportation, Transportation Systems Center, 7 March 1980.

"Competition Between Public and Private Enterprise," presented to Western Carolina University, 15 January 1981.

"Railroad Ratemaking as Influenced by Market Dominance and Antitrust," presented at the Transportation Seminar Series, Princeton University, 14 April 1982.

"Collective Ratemaking and Antitrust in the Motor Carrier Industry," presented to the Wharton Transportation Club, 15 April 1982.

"Market Dominance, Rate Reasonableness, and the Staggers Act," presented at the Center for Transportation Studies, Massachusetts Institute of Technology, 8 October 1982.

"Common Control of Rail and Water Carriers," before the Seminar on Transportation Policies and Demand for Coal, Iron, and Steel, National Coal Association and American Iron and Steel Institute, Louisville, KY, 27 February 1984.

"Obstacles to the Transition to Deregulation in the Rail Industry: Rail Merger Policy," 39th Annual Transportation and Logistics Forum and Exposition, National Transportation Defense Association, 23-26 September 1984, San Francisco.

"Competitive Access: A Comparative Industry Approach to Vertical Foreclosure," Seventh Annual Appalachian Natural Gas Conference, Pittsburgh, PA, 7-8 May 1987.

"Competitive Access," Gas Antitrust #88, sponsored by *Gas Daily*, Houston, TX, 17-18 September 1988.

"Integrating Coal Transportation and Coal Supply Procurement," *Electric Power Research Institute: 1987 Fuel Supply Seminar*, Baltimore, Maryland, 6-8 October 1987.

"Transportation Law Concepts of Interest to Energy Lawyers," Fuel and Energy Industry Subcommittee, American Bar Association, Washington, DC, 26 April 1988.

"Competition and Regulation—Compatible Bedfellows? The Challenge of Regulating a Competitive Energy Industry," American Bar Association, Washington, DC, 18 January 1989.

"The *Duquesne* Decision: There's Less Hope for Investors than We Thought," PHB Utility Discussion Series Dinner, Washington, DC, 12 July 1989 (with A. Lawrence Kolbe).

"Regulatory Risk in a Competitive Environment," *Utilities in the '90s: Strategic Issues*, sponsored by Reid and Priest, November 8, 1989, Washington, D.C.

"Equity and Efficiency Criteria in Litigation," PHB Electric and Gas Utility Discussion Series, Washington, DC, 3 April 1990.

"Regulatory Treatment of Environmental Cleanup Liabilities: Issues and Implications," Edison Electric Institute Economics Committee Meeting, Denver, Colorado, September 20, 1990.

"Risk of the Natural Gas Pipeline Industry," Interstate Natural Gas Association of America, Rate Committee Meeting, Montebello, Quebec, September 10, 1990.

"Defining, Proving, and Measuring Antitrust Damages," American Bar Association, Section of Antitrust Law, 1991 Annual Meeting, Atlanta, Georgia, August 13, 1991.

"Pricing Market Access for Regulated Firms," Royal Commission on National Passenger Transportation, Ottawa, Canada, November 13, 1991.

"Regulatory Risk and *Duquesne*," *NARUC Advanced Regulatory Studies Program*, Williamsburg, Virginia, February 21, 1992.

"Regulatory Risk in the Ratesetting Process," teleconference sponsored by the Electric Power Committee, the ABA Section of Natural Resources, Energy, and Environmental Law, May 28, 1992.

"Environmental Economics: Who Pays for Clean Energy," Federal Energy Bar Association, Annual Meeting, Washington, DC, May 21, 1992.

"Regulatory Risk and *Duquesne*," *Advanced Workshop in Regulation and Public Utility Economics: Eleventh Annual Conference*, sponsored by Graduate School of Management, Center

for Research in Regulated Industries, the State University of New Jersey (Rutgers), Mohonk Mountain House, New Paltz, New York, May 27-29, 1992.

"Rate of Return for the 1990s: Does It Account for Environmental Cleanup Liabilities, Technological Advances, and Incentives?," American Bar Association, Section of Public Utility, Communications and Transportation Law, 1992 Annual Meeting, San Francisco, California, August 10, 1992.

"Incentive Regulation: DOs and DON'Ts," Third Annual Strategic Utility Planning Conference, Denver, Colorado, June 22-23, 1993.

"Proof of Damages," Off-the-Record Club, Boston Bar Association, March 18, 1994.

"Impact Upon LDC's Rate of Return Arising From Newly Imposed Business and Regulatory Risks," *The Changing Environment for the Natural Gas Industry in New England*, sponsored by the New England Gas Association and Federal Energy Bar Association, Boston, Massachusetts, April 6, 1994.

"Economic Issues Relating to Access to Joint Ventures," American Bar Association, Section of Antitrust Law, Washington, D.C., April 8, 1994.

"Strategic Analysis of Litigation: Structuring Your Analysis to Improve Decisions in Complex Litigation" (with Carlos Lapuerta), American Bar Association, Section of Business Law, Annual Meeting, New Orleans, August 9, 1994.

"A Rehabilitation of Fully Allocated Cost: Capacity Utilization, Pumpability, and Rate Design on the Trans Alaska Pipeline System," World Conference on Transport Research, Sidney, Australia, 1995.

"Managing and Valuing the Big Case," sponsored by the Committee on Civil Practice and Procedure, Section of Antitrust Law, Washington, DC, April 7, 1995.

"The Economics of Pricing Network Interconnection in the Market for Telecommunications in New Zealand" (with Carlos Lapuerta), International Telecommunications Society, *Interconnection: The Key to the Network of Networks*, Wellington, New Zealand, April 10-12, 1995.

"The Economics of Pricing Network Interconnection: Theory and Application to the Market for Telecommunications in New Zealand," the 16th Bonbright Center Conference, *Competition in the Local/IntraLATA Markets*, Atlanta, GA, March 25-26, 1996.

"What is it Worth? Valuing a Large Antitrust Case," Civil Practice and Procedure Committee, American Bar Association, Section of Antitrust Law, Annual Spring Meeting, March 28, 1996.

"How to Recover Stranded Costs and Achieve Competition on Equal Terms in the Electric Utility Industry," Massachusetts Continuing Legal Education, Inc., Seminar on Public Utilities Deregulation, Boston, Massachusetts, June 17, 1996.

"Utilities Stranded Costs—Ramifications of Recovery," The University of New Mexico School of Law *Symposium on Electric Utility Bypass Policy*, Albuquerque, New Mexico, August 1-2, 1996.

"Power Struggle: Antitrust and the Changing Rules of Electric Utility Competition," American Bar Association, Section of Antitrust Law, Chicago, Illinois, September 19-20, 1996.

"Compensation for the Risk of Stranded Costs," 16th Annual Electric and Natural Gas Conference, James C. Bonbright Utilities Center, Atlanta, Georgia, September 16-17, 1996.

"Antitrust Damages," Chicago Bar Association, January 15, 1997.

"Market Power Issues Raised by Electric Power Restructuring and Rate Regulation," American Bar Association, Section of Antitrust Law, April 9, 1997.

"Mergers, Acquisitions, and Strategic Alliances," New Jersey Association of Energy Engineers, 1997 Energy Futures Forum, Woodbridge, New Jersey, April 17, 1997.

"Measuring Market Power in Today's Bulk Power Markets," Bulk Power Markets Conference, Vail, Colorado, June 3-4, 1997.

"Competition and Consolidation Issues," 68th Annual Meeting, Association for Transportation Law, Logistics and Policy, Santa Fe, New Mexico, June 21-25, 1997.

"Economics as Junk Science," American Bar Association, Section of Antitrust Law, Annual Meeting, San Francisco, California, August 4, 1997.

"Case Studies of Issues Arising from Damages from a Foreclosed Business Opportunity," Litigation Section, American Bar Association Annual Meeting, San Francisco, CA, August 6, 1997.

"Long-Term Contracts and Regulatory Transitions," Transportation Economics, Policy, and Management: A Conference in Honor of John R. Meyer, Harvard University, September 5-6, 1997.

"Competitive Neutrality in Access Disputes," *The Telecommunications Industry: Effects of the 1996 Act*, The Carlton Hotel, Washington, DC, September 18-19, 1997.

"Damages, Antitrust Litigation: Strategies for Success," Practicing Law Institute, November 16-17, 1998.

HONORS

Phi Beta Kappa, Emory University, 1965.

Ford Career Scholar, Emory University, 1964-1965.
Bachelor's degree awarded summa cum laude, 1965.

Woodrow Wilson Fellow, Harvard University, 1965-66.

Office of Metropolitan Development Recognition Award for Meritorious Contributions to Community Development from the U.S. Department of Housing and Urban Development, 1968.

Samuel Andrew Stouffer Fellow at the Joint Center for Urban Studies of the Massachusetts Institute of Technology and Harvard University, 1968-1969.

Air Force Commendation Medal for Meritorious Service, July 1972.

CHARLES RIVER ASSOCIATES REPORTS (WITH OTHERS)

"Forecasting Ocean Freight Shipping Rates," 1974.

"Public Costs of the Goods Movement System: Manhattan Garment Center Urban Goods Movement Study," 1975.

"Forecast of the 1975 Dry Cargo Shipping Market," 1975.

"Disaggregate Travel Demand Models," NCHRP Project 8-13: Phase I Report, 2 Vols., 1976.

"Energy Impact of Federal Capital Grants Programs for Transportation," 1976.

"Potential Fuel Conservation Measures by Regulated Motor Carriers in the Intercity Freight Market," 1977.

"Impacts of Proposals for Reform of Economic Regulation on Small Motor Carriers and Small Shippers," 1977.

"Transportation," in *Regulation and Energy Consumption*, prepared for the Committee on Measurement of Energy Consumption, National Academy of Sciences, August 1977.

"An Analysis of the Impacts of Selected Transportation Issues on National Transportation Goals," Final Report, 1978.

"Disaggregate Travel Demand Models," NCHRP Project 8-13, Phase II Report, May 1978.

"Disaggregate Travel Demand Models," NCHRP Project 8-13, Draft Final Report, November 1980.

APPENDIX B: Comments on Bernstein Testimony

1 **I. The Effects On Competitors And Mailers Are Completely Ignored**

2 Witness Bernstein calculates Ramsey prices that would require that ECR rates
3 be reduced by 42.2%, from a 0.1494 before-rates price to a 0.0864 after-rates price.¹
4 Witness Bernstein concludes that effect of rates on private enterprise competitors of
5 ECR can be safely be ignored.² Claims that competitors would be unaffected by the
6 resulting 64.0%³ increase in ECR Mail lack credibility. This alone should discredit
7 Ramsey analysis as basis for ratemaking. Bernstein also suggests mailers who switch
8 are not affected by the range of rate changes seriously considered in this proceeding,
9 stating only that "The impact on mailers of increases and decrease in postal rates is
10 measured by the change in consumer surplus."⁴

11 **II. Mail Volume Would Likely Be Dramatic Under Witness Bernstein's**
12 **Proposals**

13 Bernstein's Ramsey-pricing proposals for ECR would price dangerously close to
14 the Commission's attributable cost. His rate would generate a flood of low-rated
15 advertising mail at the expense of higher rated First Class mail.

16 **III. The Usual Objections To Ramsey Pricing Are Not Refuted**

17 The usual objections to Ramsey pricing heard repeatedly and accepted by the
18 Commission are not refuted in this case. Ramsey pricing turns upside down the public

¹ See Bernstein Testimony (USPS-T-41) at 10.

² He even states in his Testimony (USPS-T-41) at 88: "Ramsey pricing need not take account of private firms if those private firms are pricing at marginal cost."

³ See Bernstein Testimony (USPS-T-41) at 71, where the ECR volumes are predicted to increase from 31,907.6 million pieces to 52,337.1 million pieces under Ramsey pricing.

⁴ Bernstein Testimony (USPS-T-41) at 4.

1 interest standard which requires PRC regulation in the first place: protection of captive
2 customers and protection of private enterprise competitors from unfair competition from
3 a public enterprise exploiting a monopoly to underprice its competitive services.

4 **IV. Bernstein's Proposals Depend Critically On Elasticity Estimates, Which Are**
5 **Very Sensitive To Specification**

6 Ramsey pricing depends critically on the elasticities, but as witness Thress has
7 shown, the elasticity estimates are extremely sensitive to specification and time period
8 chosen. As such, Ramsey prices cannot be estimated with any degree of certainty. In
9 addition, Bernstein uses the Postal Service's methodologies for calculating volume-
10 variable costs as his rate floor, not attributable costs as calculated by the Commission,
11 which creates a special problem with ECR because of low Ramsey coverages using the
12 Commission's methodology.

13 **V. Conclusion: Ramsey Pricing Is Of No Help To The Commission**

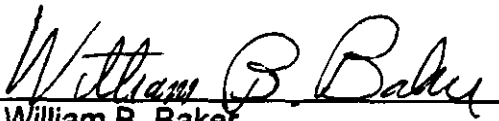
14 In practice, Ramsey pricing or consumers' surplus calculations are no help to the
15 Commission. Witness Bernstein's own data show that rates proposed by the Postal
16 Service are no more efficient than those using the Commission's methodology—the
17 consumer surplus changes very little.⁵ Indeed, USPS witnesses say it did not influence
18 their recommendations. The basic problem with Ramsey pricing has not changed:
19 changes in demand elasticity drive big changes in rates, but do not achieve major
20 changes in consumers' surplus.

⁵ Interrogatory Response NAA/USPS-T41-6 (d).

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the instant document
on all participants in this proceeding in accordance with section 12 of the
Rules of Practice.

May 22, 2000


William B. Baker